

Registration number: 2366906

# Eastern Power Networks plc

Annual Report and Financial Statements

for the Year Ended 31 March 2019



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**COMPANY INFORMATION**

**Directors**

Andrew John Hunter (Chairman)  
Hing Lam Kam  
Neil Douglas McGee  
Hok Shan Chong  
Basil Scarsella  
Charles Chao Chung Tsai  
Loi Shun Chan  
Mei Fan Ngan (Alternate director)  
Duncan Nicholas Macrae  
Kee Ham Chan (Alternate director)  
Chi Tin Wan  
Christopher Clarke  
Paul Jeffery

**Company secretary** Andrew Pace

**Registered office**

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**Auditor**

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Statutory Auditor  
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**STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2019**

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

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

- an employer of choice;
- a respected corporate citizen including delivering high quality services to the Group's customers; and
- sustainably cost efficient.

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

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

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

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

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

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

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

**STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2019**

**Business model**

The Company distributes electricity to approximately 3.6 million homes and businesses in the East Anglia / North London area via a network of underground cables and overhead lines, taking power from the National Grid at high voltage and transforming it down to lower voltage before delivery to customer premises.

The Company's objectives are to:

- maintain the safety and reliability of the electricity network;
- efficiently connect new customers to the electricity network, including power generators;
- restore supply as quickly as possible to customers who experience interruption;
- innovate to continually improve efficiency and the service provided to customers;
- facilitate a low-carbon environment by investing in assets, processes and initiatives that enable low carbon technology to be connected to the network;
- extend and upgrade the network to meet the future needs of customers; and
- keep costs to customers as low as possible.

This operating model creates a stable, reliable and sustainable business that benefits key stakeholders and wider society. The key performance indicators used to measure progress against the Company's safety, efficiency and customer service objectives are discussed on pages 5 to 7.

The Group incorporates:

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

The Company employs no staff (2018: nil). Staff are employed by UK Power Networks (Operations) Limited, which operates the distribution network on the Company's behalf with the support of UK Power Networks (Transport) Limited and UK Power Networks (South East Services) Limited.

The Company has an important contribution to make in supporting the Government's move to a low carbon economy. The energy industry is facing significant challenges in meeting both the low carbon agenda and increased customer demand. Key areas of focus include the roll-out of smart meters and accommodating new low carbon technologies (such as wind and solar renewable energy and electric vehicles) to integrate effectively and efficiently with the network. It is anticipated that electricity storage technology will become more important in the next few years as the need for greater system flexibility increases. The role of the Company is expected to transform from being a Distribution Network Operator (DNO) which manages the network to a Distribution System Operator (DSO) which is proactive and enables a smart, flexible system that responds to customer needs.

**STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2019**

**Business model continued**

The Company operates within a regulated environment with the major part of the Company's revenue being set as part of a price control review by the industry regulator, the Office of Gas and Electricity Markets (Ofgem or the Regulator). These financial statements report on the fourth year of the RII0-ED1 price control period which is of eight years duration from 1 April 2015 to 31 March 2023. Each price control provides for the licensed distributor to earn a level of "allowed" revenue. The total amount of allowed revenue takes into account a number of factors including the capital expenditure plans of the business, an efficient level of operating costs, the cost of financing the business as well as a return on the regulated asset value.

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

In addition to allowed revenues the Company collects income to cover the cost of connecting new customers to the network. Connections work which can only be carried out by the Company, for technical and safety reasons or as defined by the Regulator, is referred to as "non contestable" and is charged at cost to the customer. Work that other providers can undertake is referred to as "contestable" and is charged to the customer at a 4% regulated margin except in market segments where UK Power Networks has passed a competition test set by the Regulator in which case the price regulation is removed. UK Power Networks has passed the competition test in 14 out of a possible 27 market segments which compares favourably with other DNOs.

**Review of the business**

The revenues of the Company are subject to the regulatory price control framework set by Ofgem which provides economic incentives to maximise operating, capital and financing efficiencies. The Directors aim to optimise shareholder returns through the safe operation of and efficient investment in the network, while seeing that the business delivers high levels of customer service and operates within the boundaries of the price control allowances.

The allowed revenue is calculated to finance an efficient level of operating costs, a capital expenditure programme and deliver a return on investment on the regulatory asset value. The DNOs have an opportunity to outperform the allowed return through the delivery of efficiencies beyond the regulatory cost allowances and through other performance based incentive mechanisms. Such outperformance delivers benefits to customers and creates value for shareholders. The key areas of focus are:

- outperforming the cost allowances set by Ofgem through the delivery of sustainable efficiencies;
- improving network performance by reducing the number and average length of power interruptions and outperforming the targets set by Ofgem; and
- improving the levels of customer service across key points of the business.

## STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2019

## Review of the business continued

## Performance for the year ended 31 March 2019

Earnings before interest, taxation, depreciation and amortisation (EBITDA) has decreased by £0.7m to £447.3m reflecting a reduction in turnover of £17.2m offset by a reduction in operating costs (excluding depreciation and amortisation) of £16.5m. Gross capital expenditure on tangible assets was £358.1m, an increase of £34.2m compared to the prior year. This expenditure relates primarily to improvements to the electricity network. Capital expenditure net of customer contributions has increased by £6.3m to £255.5m reflecting the increase in gross capital expenditure partially offset by an increase in customer contributions of £27.9m.

During the year a greater proportion of connections projects were capital in nature resulting in a higher proportion of costs and income deferred to the balance sheet and contributing to the reduction in operating costs and turnover noted above.

Compared to the prior year, profit after tax has reduced from £185.3m to £162.3m due predominantly to higher finance costs resulting from changes to the fair value of derivative swap instruments.

## Key performance indicators (KPI's)

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

		Year ended 31 March 2019	Year ended 31 March 2018
<b>Financial key performance indicators</b>			
Turnover (£m)		<b>625.4</b>	642.6
EBITDA (£m)	1	<b>447.3</b>	448.0
Profit after tax (£m)		<b>162.3</b>	185.3
Gross capital expenditure on tangible assets (£m)		<b>358.1</b>	323.9
Capital expenditure on tangible assets net of customer contributions received (£m)		<b>255.5</b>	249.2
<hr/>			
		<b>As at 31 March 2019</b>	<b>As at 31 March 2018</b>
Regulatory asset value (RAV) (£m)	2	<b>2,698.1</b>	2,630.4
RAV gearing	3	<b>67%</b>	65%

1 EBITDA is a non-statutory measure, and is calculated by adding back amortisation and depreciation to operating profit (also explained in subsequent paragraphs).

2 RAV is the Regulatory Asset Value of the business. The 31 March 2019 RAV presented is provisional at the date the accounts are signed. Discussion with Ofgem may result in RAV being increased or decreased. The prior year comparatives have been restated to reflect the latest agreed position.

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

## STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2019

## Financial key performance indicators continued

**EBITDA**

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

	Year ended 31 March 2019	Year ended 31 March 2018
Operating profit (£m)	302.4	307.3
Depreciation of tangible fixed assets (£m)	132.4	129.4
Amortisation of intangible assets (£m)	12.5	11.3
<b>EBITDA (£m)</b>	<b>447.3</b>	<b>448.0</b>

Removing the effect of depreciation and amortisation from operating profit provides a clearer measure of operating efficiencies within the business and enables comparison with industry peers.

**Capital expenditure**

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

	Year ended 31 March 2019	Year ended 31 March 2018
Gross capital expenditure on tangible assets (£m)	358.1	323.9
Less: Customer contributions received in the year (£m)	(102.6)	(74.7)
<b>Capital expenditure net of customer contributions (£m)</b>	<b>255.5</b>	<b>249.2</b>

**RAV gearing**

The proportion of debt measured against the Regulatory Asset Value of the business indicates the capacity of the business to source additional finance. This is a key metric for the Company's covenant arrangements with pension trustees and providers of finance. The increase from 65% to 67% in the year shows the level of debt growing faster than the RAV.



## STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2019

**Non-financial key performance indicators**

The principal non-financial key performance indicators focus on network safety and performance and customer service.

**Safety**

The Group's top priority is the safety of employees, contractors and the general public. The safety performance of the Group as a whole is reviewed in the Group's annual report and financial statements. Lost time incidents (LTIs), defined as the number of injuries to employees or contractors which result in lost time of one day or more, is a key safety measure. During the financial year the Group recorded 3 LTIs which is the same number as the prior year.

**Network performance**

The principal measures used to assess network performance are customer minutes lost (CMLs) and customer interruptions (CIs). CMLs are the average length of time customers are without power for three minutes or longer and represent availability of supply. CIs, the number of interruptions per 100 customers, are an indicator of network reliability. The table below shows improvement in both CIs and CMLs compared to the prior year. The Company remains ahead of targets set by Ofgem.

	Year ended 31 March 2019	Year ended 31 March 2018
* Customer Minutes Lost per customer (CMLs)	34.9	41.8
* Customer Interruptions per 100 customers (CIs)	41.7	48.5

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

**Customer satisfaction**

Ofgem measures customer satisfaction of all the DNOs and this is one of the most important measures of performance. The customer satisfaction survey captures customers' experiences of the services provided by the DNOs, for interruptions, minor connections and general enquiries. The Company has improved from a score of 87% in the prior year to 88% in the current year and is above the industry-wide target of 82%.

**Principal risks and uncertainties**

As well as the opportunities the Company has to grow and develop its business, certain risks and uncertainties are faced in achieving its objectives. The Company's principal risks and uncertainties, and a summary of actions to mitigate them, are set out in tabular form below. There have been no significant changes in the exposure to these risks during the year.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2019

Risk	Mitigation
<b>Health and safety incidents</b>	
<p>There is a risk that a fatality or serious injury occurs involving a member of staff, a contractor, a member of the public or a third party. Any such incident could lead to a prosecution or a fine and have an adverse impact on the reputation of the Company.</p>	<p>The Group aims to create and foster a culture in which safety is the highest priority in the minds of everyone who works at UK Power Networks. The Group runs a range of programmes and initiatives, such as its Be Bright Stay Safe campaign, aimed at staff and those outside of the Group, to promote safety and make them aware of potential hazards and how to operate in hazardous situations.</p>
	<p>The Group actively monitors, measures and investigates safety incidents, including near misses, and seeks to learn from each one.</p>
<b>Major outage of network assets</b>	
<p>There are significant risks associated with network assets where failure could result in a loss of supply of electricity to customers. Customer service and continuity/quality of supply are important regulatory requirements and poor performance in these areas can result in financial penalties. Any significant incident could cause adverse publicity and impact negatively on the reputation of the Company.</p>	<p>The reliability of the Company's network is a key performance indicator and is closely monitored by the Company. Investment in the network is prioritised to those projects which are likely to have the most beneficial impact on reliability, and the Company strives to continually innovate to improve the ways in which it identifies and manages the risk of outages. The Group has a well developed plan for dealing with storms and other major weather events, and has extended that planning activity to other potentially damaging events such as pandemic flu.</p>
	<p>Through its risk management activities, the Group has become the first DNO to achieve level 4 from the Cabinet Office Emergency Planning College assessment for Organisational Resilience based on BS 65000:2014 Guidance on Organisational Resilience.</p>

## STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2019

Risk	Mitigation
<b>Cyber security breach</b>	
<p>A cyber security breach which results in a failure of the Company's core systems, applications or associated IT processes could have a significant impact in a number of areas. Business operations could be affected and if the breach or failure is related to control systems, the Company's ability to operate the network could be impacted. Data breaches could result in legal or regulatory non-compliance with resulting financial penalties and reputational damage.</p>	<p>A Cyber Security Improvement Programme operates to reduce risks, strengthen controls and maintain compliance with changes in standards and legislation. The Group focuses its activities in this area across three domains: operating a cyber security management system; maintaining cyber hygiene; and proactively testing resilience. All security policies and standards are closely aligned to ISO 27001 and are compliant with the requirements of applicable legislation. The Group operates a training programme to see that all its staff are aware of cyber risks and know how to minimise and manage those risks, as well as how to respond in the event of a suspected breach.</p>
<b>Regulatory environment</b>	
<p>The prices which can be charged for the use of the Company's networks are determined in accordance with the Regulator approved price controls. The current price control, RIIO-ED1, comes to an end in March 2023 when a new price control RIIO-ED2 will come into force. The methodology for pricing in RIIO-ED2 is not yet known and could result in lower financial returns in future years as a result of RIIO-ED2.</p>	<p>Industry regulation is set by Ofgem who operate independently of the DNOs, and therefore there is limited ability for the Group to directly mitigate this risk. However the Group regularly engages with Ofgem directly and through formal consultation processes, and with other industry bodies in various forums, to ensure the Group's interests are represented in industry discussions.</p>
<b>Funding and liquidity risk</b>	
<p>The Company's financing requirements are partially met through bonds and bank lending facilities.</p>	<p>The Company has established a Treasury Committee, a sub-committee of the Group Board, which oversees the setting of treasury policy and guidelines, and seeks to ensure that treasury risks are identified and managed.</p>

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2019

Risk	Mitigation
<b>Funding and liquidity risk (continued)</b>	
<p>There is a risk that the Company is not able to access funding at acceptable rates, either through changes in market conditions or through a downgrade in the credit rating of the Company, or through breaching covenants on existing facilities.</p>	<p>The Company monitors its financial position carefully on a regular basis, including the use of detailed financial projections that assess funding requirements and performance against credit metrics and covenants of the Company. The Company has spread its debt maturities over a number of years in order to reduce the concentration of funding risk in any one financial year.</p> <p>More details of the Company's approach to dealing with financial risks are shown on page 11 and 12.</p>
<b>Non-compliance with regulatory requirements</b>	
<p>The electricity industry is subject to extensive regulatory obligations with which the Company must comply. Non-compliances can result in financial penalties and have a negative reputational impact.</p>	<p>The Group operates a Regulatory Compliance programme which seeks to ensure that regulatory risks and obligations are understood, with controls and processes in place to meet regulatory compliance requirements and to manage risks of non-compliance.</p>

**STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2019**

**Principal risks and uncertainties continued**

The Company continues to monitor the political environment and consider the implications of the UK's exit from the European Union ("Brexit") as well as the Labour Party's plans for nationalisation if they come to power.

The Company only distributes electricity in the UK and therefore the impact of Brexit on its core operations is expected to be low. The Company is working closely with its suppliers regarding continuity of supply in the event of disruption at customs borders.

In May 2019, the Labour Party published a paper ("Bringing Energy Home: Labour's proposal for publicly owned energy networks") containing details of its policy to bring energy networks (including distribution networks) back into public ownership through an Act of Parliament. The paper set out that compensation for the transfer of assets would be funded through a bond issuance by Treasury and that the level of compensation would be decided by Parliament. In addition, it stated that existing debts of the companies would be carried over with the companies under public ownership and honoured in full, with refinancing over time. The policy may, however, evolve over time.

**Risk identification and management**

There are a variety of mechanisms in place to manage the Company's risks. The Group has an embedded risk awareness culture to understand and manage significant business risks. The risk management framework sets out policies, procedures and responsibilities designed to assess, mitigate, monitor and report risks. A subcommittee of the Group Board, the Risk Management and Compliance committee, oversees the risk management function and makes annual assessments of changes to significant risks and the effectiveness of the risk management processes.

Control procedures have been implemented throughout the Group and are designed to achieve complete and accurate accounting for financial transactions, to safeguard the Group's assets and for compliance with laws and regulations. The Group's Board of Directors has established the scope of the internal audit function which is responsible for reviewing the effectiveness of the Group's systems of internal control and reports to the Audit Committee of the Group Board.

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

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

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2019

**Financial risk management objectives and policies**

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

At 31 March 2019 the Company had net debt of £1,818.1m (2018: £1,741.6m) comprising £1,415.6m (2018: £1,384.9m) in bonds, loans from the European Investment Bank of £365.5m (2018: £364.1m) and Group loans of £40.0m (2018: £nil) offset by cash balances of £3.0m (2018: £7.4m). The Company's principal financial assets are its cash balances, trade and other receivables and loans to Group undertakings.

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

**Interest rate risk**

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

**Credit and liquidity risk**

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

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

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

**Pension commitments**

A significant proportion of the Group's employees are members of two funded defined benefit pension schemes: the UK Power Networks Group of the Electricity Supply Pension Scheme (the UKPN Group Scheme); and the UK Power Networks Pension Scheme (the UKPNPS). The Company's share of the Group's pension deficit obligations accounted for under FRS 102 at 31 March 2019 amounts to £40.9m (2018: £71.6m). Both defined benefit schemes are closed to new members. The Group's new employees have the option to join a defined contribution pension scheme which was introduced in 2011.

## STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2019

**Taxation**

The Company operates entirely within the United Kingdom and is subject to all the main charges which fall under UK legislation. These include corporation tax, VAT, national insurance, regulatory licence fees, local authority fees (such as road permits issued under the New Roads and Streetworks Act) and relevant rates. The Company has a significant long term capital expenditure programme which generates a charge against taxable profit through capital allowances. The timing of the tax relief on these allowances has the effect of delaying the payment of corporation tax and giving rise to a deferred tax liability. At 31 March 2019 the Company's net deferred tax liability was £174.8m (2018: £190.2m).

**Factors likely to affect future development and performance**

The following trends and factors are expected to influence the future financial position and performance of the Company.

*Price Control RIIO-ED1*

The current price control RIIO-ED1 applies for an eight year period from 1 April 2015 to 31 March 2023 and determines the allowed revenue the Company is able to collect from its customers and the outputs the Company is required to deliver, until 2023. RIIO stands for "Revenues driven by Incentives, Innovation and Outputs". Allowed revenue covers the cost of operating and maintaining the network through an "in year" allowance for regulatory expenditure plus the regulatory return and regulatory depreciation on that regulatory expenditure which enters the Regulatory Asset Base, pass-through costs, incentives, tax, and pensions. The Company has the opportunity to outperform the allowed revenue either by delivering its agreed outputs at a cost below the regulatory cost allowances or through its performance against the RIIO-ED1 incentive mechanisms. The RIIO model identifies six output categories with a range of incentive mechanisms attached:

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

## STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2019

### Factors likely to affect future development and performance continued

#### *Environment*

The Company is committed to playing an active role in reducing carbon emissions and minimising the environmental impact of its activities. While taking steps to reduce its own carbon footprint the Company is investing in initiatives to enable the use of technologies such as renewable wind and solar energy, electric vehicles, and electricity storage on its network.

Other environmental activities include the reduction of pollution through replacement of fluid filled cables, the control and mitigation of losses from equipment containing oil and the greenhouse gas Sulphur Hexafluoride, a reduction in the use of herbicides, and a commitment to the under-grounding of cables in areas of outstanding natural beauty and national parks.

The Group recognises the importance of its environmental responsibilities and undertakes its operations in an environmentally sensitive manner, complying with all relevant legislative requirements. The Group is committed to the protection of the environment in the region it serves and its environmental management systems are certified under ISO14001.

#### *Workforce renewal programme*

The Company benefits from various recruitment and training programmes designed to develop the UK Power Networks workforce to meet the future resource requirements of the distribution business.

The recruitment and training of technically skilled staff is promoted through graduate and engineering development programmes, apprentice schemes and a smart metering traineeship. Due to the large number of staff working on the distribution network, management training is important for safety, quality of work and efficiency and is sourced either internally through the Human Resources function or through third-party suppliers.

#### *Research and development*

The Company is involved in research and development activities focusing on improving the technical performance of the network and working towards achieving national carbon reduction targets. RIIO-ED1 has two main funding mechanisms to provide additional incentives for innovation expenditure:

- The Network Innovation Allowance of 0.5% of base revenues per annum; and
- The Network Innovation Competition which is an annual competition for funding larger scale innovative projects that have the potential to deliver carbon or other environmental benefits to consumers.

#### *Key long-term issues*

The key long-term issues considered beyond 2019 relate to the areas listed below:

- Integration: Continued integration of activities to fewer locations to capture synergies;
- Regulatory: The increased focus under RIIO-ED1 on environmental targets, the development of low carbon initiatives and security of supply and looking ahead to the next price control RIIO-ED2 from April 2023; and
- Technology: Development of smart distribution grids to accommodate the growth of new technologies such as renewable energy (wind and solar) installations, electricity storage technology, smart metering, smart heating and lighting systems and electric vehicles.



**STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2019**

**Going concern**

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

In considering the going concern basis in preparing the financial statements the Directors have taken the Company's annual budget and long term strategic plan into account as well as the following factors:

- The Company profitably operates the regulated electricity distribution network in the East Anglia / North London area. The revenue of the Company is regulated by Ofgem via established price control mechanisms providing a stable and predictable source of cash flows.
- The Company is funded predominantly by debt with an average maturity of seven years and has access to a revolving credit facility of £105.0m until March 2022 which was undrawn at the balance sheet date. Total borrowings (excluding derivatives) amounted to £1,821.1m (2018: £1,749.0m) of which £120.0m (2018: £nil) was short term.
- In July 2018 the Company raised additional financing of £33.8m from the issue of a 20 year fixed rate bond for JPY 5 billion. The exchange rate exposure on the bond is hedged by a cross currency swap transacted on the same date. Taking into account the effect of the cross currency swap, the net fixed interest rate is 2.972% per annum.
- As required by the electricity distribution licence the Company has an investment grade credit rating and has the ability to access external debt markets supported by cash generated by its operations.

The Company's forecasts and projections, taking account of reasonably possible changes in trading performance, demonstrate that the Company will be able to operate within its credit facilities. The Directors are satisfied that the Company has adequate resources to continue operating for the foreseeable future and on this basis the principle of a going concern has been adopted in the preparation of the financial statements.

Approved by the Board on 23 July 2019 and signed on its behalf by:



Basil Scarsella  
Director

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

**DIRECTORS' REPORT FOR THE YEAR ENDED 31 MARCH 2019**

The Directors present their Annual Report including the Audited Financial Statements of the Company for the year ended 31 March 2019.

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

**Dividends**

Dividends of £101.0m were paid during the year (2018: £108.7m).

**Political contributions**

The Company made no political contributions during the year (2018: £nil).

**Directors of the Company**

The directors who held office during the year were as follows:

Andrew John Hunter (Chairman)

Hing Lam Kam

Neil Douglas McGee

Hok Shan Chong

Basil Scarsella

Charles Chao Chung Tsai

Loi Shun Chan

Mei Fan Ngan (Alternate director)

Duncan Nicholas Macrae

Kee Ham Chan (Alternate director)

Chi Tin Wan

Christopher Clarke

Paul Jeffery

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

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

**DIRECTORS' REPORT FOR THE YEAR ENDED 31 MARCH 2019**

**Disclosure of information to Auditor**

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

- so far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- the Director has taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

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

**Auditor**

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

Approved by the Board on 23 July 2019 and signed on its behalf by:

A handwritten signature in black ink, appearing to read 'Basil Scarsella', written over a dotted line.

Basil Scarsella  
Director

**STATEMENT OF DIRECTORS' RESPONSIBILITIES**

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

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

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

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

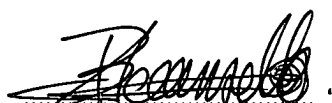
The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies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

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

The Directors confirm to the best of their knowledge that:

- the Financial Statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets and liabilities, financial position and profit of Eastern Power Networks plc as at 31 March 2019; and
- the Strategic Report and the Directors' Report include a true and fair view of the development and performance of the business and the financial position of Eastern Power Networks plc, together with a description of its principal risks and uncertainties.

Approved by the Board on 23 July 2019 and signed on its behalf by:



Basil Scarsella  
Director

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

### Report on the audit of the financial statements

#### Opinion

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

- give a true and fair view of the state of the company's affairs as at 31 March 2019 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the Profit and Loss Account;
- the Statement of Comprehensive Income;
- the Balance Sheet;
- the Statement of Changes in Equity;
- the Cash Flow Statement; and
- the related notes 1 to 22.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, 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 as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the company.

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

Summary of our audit approach	
<b>Key audit matters</b>	The key audit matters that we identified in the current year were: <ul style="list-style-type: none"><li>• Accuracy of Cost Classification; and</li><li>• Accuracy of Financial Instruments.</li></ul>
<b>Materiality</b>	We have set materiality at £18.2 million which was determined on the basis of approximately 7.5% of profit before tax.
<b>Scoping</b>	The company is in full scope of our audit.
<b>Significant changes in our approach</b>	Our approach is consistent with the previous year.

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

### Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

***We confirm that we have nothing material to report, add or draw attention to in respect of these matters.***

### Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

Throughout the course of our audit we identify risks of material misstatement ("risks") and classify those risks according to their severity. In assigning a category we consider both the likelihood of a risk of a material misstatement and the potential magnitude of a misstatement in making the assessment. Certain risks are classified as "significant" or "higher" depending on their severity. The category of the risk determines the level of evidence we seek in providing assurance that the associated financial statement item is not materially misstated.

We have described herein the risk categorisation assigned to each of our key audit matters and the reasoning behind that judgement.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Accuracy of Cost Classification	
Key audit matter description	<p>The company continues to have an extensive capital investment programme. To meet the requirements of FRS 102.17 <i>Property Plant and Equipment</i> ("PP&amp;E"), it is important that network costs are appropriately classified as either capital or operating expenditure in nature. In the year, the company capitalised £350.9 million (2018: £318.5 million) in relation to network assets.</p> <p>The classification of activities between capital (additions or enhancements to network assets) and operating expenditure (maintenance or network repair) is impacted by judgements undertaken by management, as well as a degree of complexity surrounding the allocation of network costs using a range of network cost drivers. Due to the judgements and complexity surrounding these cost drivers, we have identified the accuracy of cost classification to be a key audit matter as well as potential fraud risk. The key audit risk is that costs may not be correctly classified across operating and capital expenditure due to these judgemental assumptions, causing an overstatement of capital expenditure / understatement of operating expenditure.</p> <p>The classification of costs have been disclosed in the accounting policies in Note 2 and in Note 10.</p>

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

<b>How the scope of our audit responded to the key audit matter</b>	<p>We performed the following procedures:-</p> <ul style="list-style-type: none"> <li>• Evaluated the design and implementation and tested the operating effectiveness of controls over the classification of expenditure;</li> <li>• Assessed whether the Group's accounting policies in relation to capitalisation comply with FRS 102.17 <i>PP&amp;E</i> and to test the implementation of these policies through a combination of controls testing for the procurement process and substantive testing of the documentation behind the costs;</li> <li>• Assessed the assumptions and judgements made by management in relation to cost drivers used for each cost category as well as consistency with the prior year and challenged any changes made in the year; and</li> <li>• Tested the cost allocation model and the outcome of the year end cost review with particular emphasis on overhead capitalisation.</li> </ul>
<b>Key observations</b>	<p>The results of our procedures were satisfactory and on the basis of these we concluded the classification of costs is appropriate.</p>

<b>Accuracy of Financial Instruments</b>	
<b>Key audit matter description</b>	<p>As at 31 March 2019, the company had total borrowings (fixed and variable rates) of £1,821.1 million (2018: £1,749.0 million). The company mitigates the exposure to interest rate risk, exchange rate risk and inflation risk with risk management activities including the use of complex derivatives including interest rate, cross currency swaps and RPI swaps.</p> <p>The accuracy of the hedge accounting treatment is by its nature complex and requires the exercise of judgement by management. Due to the complexity in employing hedge accounting as well as the judgements undertaken, we have identified the accuracy of financial instruments as a key audit matter. The company designates derivatives in hedge relationships where possible.</p> <p>At the year end, the company had derivative financial assets of £52.5 million (2018: £53.5 million) and derivative financial liabilities of £326.0 million (2018: £280.0 million). The treatment of derivative financial instruments and hedge accounting is disclosed in the accounting policies in Note 2 as well as in Notes 14 and 15.</p>
<b>How the scope of our audit responded to the key audit matter</b>	<p>We performed the following procedures:-</p> <ul style="list-style-type: none"> <li>• Tested all aspects of the accounting for financial instruments, including the documentation of the hedge effectiveness testing performed as well as the ongoing treatment followed for all derivative instruments;</li> <li>• Utilised a financial instrument specialist in the challenge of the hedge effectiveness testing; and</li> </ul>

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

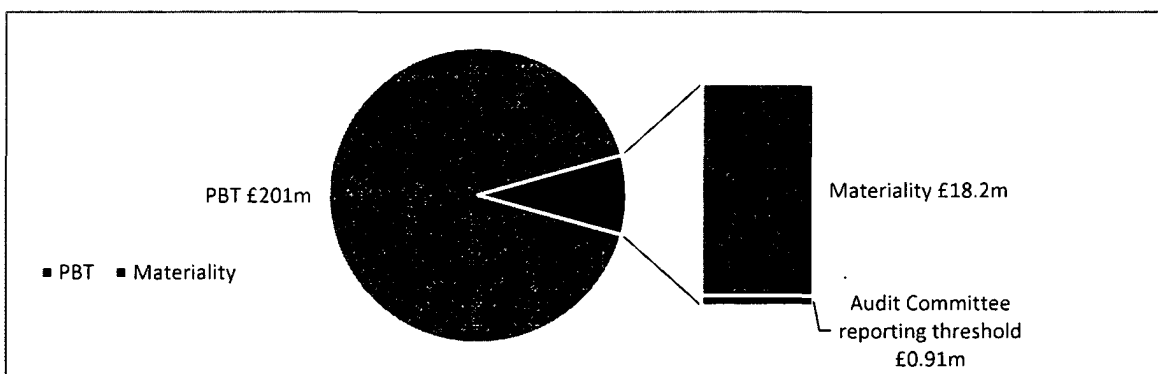
	<ul style="list-style-type: none"> <li>For new swaps and hedges implemented in the year, we tested documentation to confirm the instruments have been accounted for appropriately.</li> </ul>
<b>Key observations</b>	The results of our procedures were satisfactory and on the basis we conclude the accuracy of financial instruments is appropriate.

### Our application of materiality

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

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

<b>Materiality</b>	£18.2 million (2018: £19.4 million)
<b>Basis for determining materiality</b>	Approximately 7.5% of profit before tax (2018: 7.5%)
<b>Rationale for the benchmark applied</b>	<p>As a profit making entity, profit before tax is a key metric used by users of the financial statements.</p> <p>We conducted an assessment of which line items we understand to be the most important to investors and analysts by reviewing the Company's communications to shareholders and lenders, as well as the communications of peer companies. This assessment resulted in us considering the financial statement line item above.</p>



Performance materiality for the current year has been set at £12.7 million (2018: £13.5 million), or 70% of materiality (2018: 70%).



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

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole. In determining performance materiality, we considered factors including:

- our risk assessment, including our assessment of the company's overall control environment; and
- our prior year experience of the audit, which has indicated a low number of corrected and uncorrected misstatements identified.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.91 million (2018: £0.97 million), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

### An overview of the scope of our audit

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Our audit was scoped by obtaining an understanding of the company and its environment, including wider UK Power Networks Holdings group-wide controls, and assessing the risks of material misstatement at the company and group level. The company is in full scope for the purposes of our audit and all the audit work is performed directly by the group audit team.

### Other information

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

***We have nothing to report in respect of these matters.***

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.

In connection with our audit of the financial statements, 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 audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. 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.

### Responsibilities of directors

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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.

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

### Auditor's responsibilities for the audit of the financial statements

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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.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud are set out below.

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](http://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

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We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

#### *Identifying and assessing potential risks related to irregularities*

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, our procedures included the following:

- enquiring of management, internal audit, and the audit committee, including obtaining and reviewing supporting documentation, concerning the company's policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud; and
  - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations.
- discussing among the engagement team and involving relevant internal specialists, including tax, valuations, pensions, and IT specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we identified the potential for fraud in the following area: accuracy of cost classification; and
- obtaining an understanding of the legal and regulatory framework that the company operates in, focusing on those laws and regulations that had a direct effect on the financial statements or that had a fundamental effect on the operations of the company. The key laws and regulations we considered in this context included the UK Companies Act, Listing Rules, pensions legislation and tax legislation. In addition, compliance with terms of the company's operating licence and regulatory solvency requirements were fundamental to the company's ability to continue as a going concern.

#### *Audit response to risks identified*

As a result of performing the above, we identified accuracy of cost classification as a key audit matter. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures we performed in response to that key audit matter.

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

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Our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with relevant laws and regulations discussed above;
- enquiring of management, the audit committee and in-house legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with HMRC and the licensing; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

### Report on other legal and regulatory requirements

#### Opinions on other matters prescribed by the Companies Act 2006

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

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

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

#### Matters on which we are required to report by exception

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##### *Adequacy of explanations received and accounting records*

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

***We have nothing to report in respect of these matters.***

##### *Directors' remuneration*

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

***We have nothing to report in respect of this matter.***

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

### Other matters

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#### *Auditor tenure*

Following the recommendation of the audit committee, we were appointed by the board in 1999 and were reappointed following an audit tender in 2017 to audit the financial statements for the year ending 31 March 2018 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 21 years, covering the years ending 31 December 1999 to 31 March 2019.

#### *Consistency of the audit report with the additional report to the audit committee*

Our audit opinion is consistent with the additional report to the audit committee we are required to provide in accordance with ISAs (UK).

### Use of our report

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This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.



**Makhan Chahal, ACA (Senior Statutory Auditor)**

For and on behalf of Deloitte LLP

Statutory Auditor

London, United Kingdom

23 July 2019

## EASTERN POWER NETWORKS PLC

### PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 MARCH 2019

	Note	2019 £ m	2018 £ m
<b>Turnover</b>	4	<b>625.4</b>	642.6
Cost of sales		<u>(29.2)</u>	<u>(31.6)</u>
<b>Gross profit</b>		<b>596.2</b>	611.0
Distribution costs		<b>(287.2)</b>	(296.9)
Administrative expenses		<u>(6.6)</u>	<u>(6.8)</u>
<b>Operating profit</b>	5	<b>302.4</b>	307.3
Finance costs (net)	7	<u>(101.4)</u>	<u>(75.2)</u>
<b>Profit before tax</b>		<b>201.0</b>	232.1
Taxation	8	<u>(38.7)</u>	<u>(46.8)</u>
<b>Profit for the financial year</b>		<u><b>162.3</b></u>	<u>185.3</u>

The above results were derived from continuing operations.

The notes on pages 32 to 67 form an integral part of these financial statements.

# EASTERN POWER NETWORKS PLC

## STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 MARCH 2019

	2019 £ m	2018 £ m
<b>Profit for the year</b>	<b>162.3</b>	<b>185.3</b>
Fair value losses deferred to hedging reserves	(1.1)	-
Reclassified to profit or loss from hedging reserves	(0.4)	0.4
Remeasurement of net defined benefit pension liability	21.2	15.7
Other comprehensive income	19.7	16.1
<b>Total comprehensive income for the year</b>	<b>182.0</b>	<b>201.4</b>

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

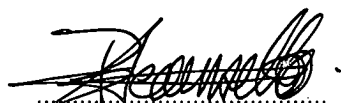
The notes on pages 32 to 67 form an integral part of these financial statements.

# EASTERN POWER NETWORKS PLC

## BALANCE SHEET AS AT 31 MARCH 2019

	Note	2019 £ m	2018 £ m
<b>Fixed assets</b>			
Intangible assets	9	43.6	45.9
Tangible assets	10	<u>4,874.5</u>	<u>4,649.3</u>
		<u>4,918.1</u>	<u>4,695.2</u>
<b>Current assets</b>			
Debtors falling due within one year	11	76.0	74.6
Debtors falling due after more than one year	11	197.0	198.0
Cash and cash equivalents		<u>3.0</u>	<u>7.4</u>
		276.0	280.0
<b>Creditors: Amounts falling due within one year</b>	12	<u>(391.3)</u>	<u>(267.6)</u>
<b>Net current (liabilities)/assets</b>		<u>(115.3)</u>	<u>12.4</u>
<b>Total assets less current liabilities</b>		4,802.8	4,707.6
<b>Creditors: Amounts falling due after more than one year</b>	12	(3,141.4)	(3,083.0)
<b>Provisions for liabilities</b>	16	<u>(230.3)</u>	<u>(274.5)</u>
<b>Net assets</b>		<u>1,431.1</u>	<u>1,350.1</u>
<b>Capital and reserves</b>			
Called up share capital	17	125.8	125.8
Share premium reserve	17	5.6	5.6
Capital redemption reserve	17	10.6	10.6
Hedging reserves	17	(1.5)	-
Profit and loss account	17	<u>1,290.6</u>	<u>1,208.1</u>
<b>Total shareholders' funds</b>		<u>1,431.1</u>	<u>1,350.1</u>

The financial statements of Eastern Power Networks plc, registered number 2366906, were approved by the Board of Directors and authorised for issue on 23 July 2019. They were signed on its behalf by:



Basil Scarsella  
Director

The notes on pages 32 to 67 form an integral part of these financial statements.

**EASTERN POWER NETWORKS PLC**

**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH 2019**

	Share capital £ m	Share premium reserve £ m	Capital redemption reserve £ m	Profit and loss account £ m	Hedging reserves £ m <sup>1</sup>	Total £ m
At 1 April 2017	<u>125.8</u>	<u>5.6</u>	<u>10.6</u>	<u>1,115.8</u>	<u>(0.4)</u>	<u>1,257.4</u>
Profit for the year	-	-	-	185.3	-	185.3
Remeasurement of defined benefit pension liability	-	-	-	15.7	-	15.7
Reclassified to profit or loss	-	-	-	-	0.4	0.4
Total comprehensive income	-	-	-	201.0	0.4	201.4
Dividends	-	-	-	(108.7)	-	(108.7)
At 31 March 2018	<u>125.8</u>	<u>5.6</u>	<u>10.6</u>	<u>1,208.1</u>	<u>-</u>	<u>1,350.1</u>

	Share capital £ m	Share premium reserve £ m	Capital redemption reserve £ m	Profit and loss account £ m	Hedging reserves £ m <sup>1</sup>	Total £ m
At 1 April 2018	<u>125.8</u>	<u>5.6</u>	<u>10.6</u>	<u>1,208.1</u>	<u>-</u>	<u>1,350.1</u>
Profit for the year	-	-	-	162.3	-	162.3
Remeasurement of defined benefit pension liability	-	-	-	21.2	-	21.2
Fair value losses deferred to hedging reserves	-	-	-	-	(1.1)	(1.1)
Reclassified to profit or loss	-	-	-	-	(0.4)	(0.4)
Total comprehensive income	-	-	-	183.5	(1.5)	182.0
Dividends	-	-	-	(101.0)	-	(101.0)
At 31 March 2019	<u>125.8</u>	<u>5.6</u>	<u>10.6</u>	<u>1,290.6</u>	<u>(1.5)</u>	<u>1,431.1</u>

1 Hedging reserves comprise the cash flow hedge reserve and cost of hedging reserve. Refer to note 17 for further detail.

The notes on pages 32 to 67 form an integral part of these financial statements.



# EASTERN POWER NETWORKS PLC

## CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 2019

		2019 £ m	2018 £ m
<b>Cash generated from operations</b>	20	424.9	397.9
Corporation tax paid		<u>(80.3)</u>	<u>(21.9)</u>
Net cash flows from operating activities		<u>344.6</u>	<u>376.0</u>
<b>Cash flows from investing activities</b>			
Proceeds from sale of tangible assets		0.3	0.4
Gross capital expenditure on tangible assets		(356.0)	(321.7)
Customer contributions		102.6	74.7
Capital expenditure on intangible assets		(10.2)	(13.6)
Interest received		<u>4.2</u>	<u>3.9</u>
Net cash flows used in investing activities		<u>(259.1)</u>	<u>(256.3)</u>
<b>Cash flows from financing activities</b>			
Equity dividends paid		(101.0)	(108.7)
Interest paid		(62.5)	(59.5)
Proceeds from long-term borrowings		33.6	50.0
Proceeds from short-term borrowings		<u>40.0</u>	<u>-</u>
Net cash flows used in financing activities		<u>(89.9)</u>	<u>(118.2)</u>
<b>Net (decrease)/increase in cash and cash equivalents</b>		<u>(4.4)</u>	<u>1.5</u>
Cash and cash equivalents at beginning of year		<u>7.4</u>	<u>5.9</u>
Cash and cash equivalents at end of year		<u><u>3.0</u></u>	<u><u>7.4</u></u>
<b>Reconciliation to cash at bank and in hand</b>			
Cash at bank and in hand		<u>3.0</u>	<u>7.4</u>
Cash and cash equivalents		<u><u>3.0</u></u>	<u><u>7.4</u></u>

The notes on pages 32 to 67 form an integral part of these financial statements.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019**

**1 General information**

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

The principal activities of the Company and the nature of the Company's operations are set out in the Strategic Report on pages 2 to 15.

The address of its registered office is:  
Newington House  
237 Southwark Bridge Road  
London  
SE1 6NP  
United Kingdom

**2 Accounting policies**

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

**Basis of accounting**

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

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

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

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

The Company has taken the exemption not to disclose related party transactions with other wholly owned members of the Group. In previous years, the exemption not to present a cash flow statement was also taken but this year a cash flow statement is presented on page 31 for the benefit of users of the financial statements.

**Going concern**

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

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

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

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

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

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

**Tangible assets**

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

**Depreciation**

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

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

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

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

**Borrowing costs capitalised**

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

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

**2 Accounting policies (continued)****Tax**

The tax expense for the period comprises current and deferred tax. Tax is recognised in profit or loss, except that a change attributable to an item of income or expense recognised as other comprehensive income is also recognised directly within the same component of other comprehensive income.

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

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

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

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

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

**Pension**

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

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

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

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

**2 Accounting policies (continued)****Provisions**

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

**Financial instruments****Change in accounting policy:****Recognition and measurement provisions of IFRS 9 'Financial Instruments'**

In previous years the Company applied the recognition and measurement provisions of IAS 39 'Financial Instruments: Recognition and Measurement' (as adopted for use in the EU), with the disclosure and presentation requirements of Sections 11 and 12 of FRS 102. This accounting policy choice is provided by Section 11.2b of FRS 102.

For financial years beginning on or after 1 January 2018, IAS 39 is replaced by IFRS 9 'Financial instruments' under international accounting standards. To maintain consistency with shareholder reporting, the Company has elected to apply Section 11.2c of FRS 102, which allows the recognition and measurement provisions of IFRS 9 'Financial instruments' (as adopted in the EU) with the disclosure and presentation requirements of Sections 11 and 12 of FRS 102. The change in accounting policy is effective from the start of the Company's financial year 1 April 2018.

The principal changes relevant to the Company under the recognition and measurement principles of IFRS 9 are as follows:

- IFRS 9 has introduced changes to the classification and measurement of financial assets. All recognised financial assets that are within the scope of IFRS 9 are required to be subsequently measured at amortised cost or fair value on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. As outlined further below, the Company subsequently measures financial assets at amortised cost or fair value through profit or loss. No financial assets are subsequently measured at fair value through other comprehensive income. No transition adjustments or restatements of comparatives have been necessary as the measurement at either amortised cost or at fair value through profit or loss remains the same as the previous treatment under IAS 39.
- Impairment of financial assets is calculated using a forward-looking "expected credit loss" model which replaces the incurred loss model under IAS 39. The Company has applied the simplified approach to calculate the expected credit losses on trade debtors. The new methodology has not materially affected the impairment loss allowance.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

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

- IFRS 9 introduces new rules for hedge accounting which are more principles based and aligned with the risk management objectives and strategy of the entity. The Company has prospectively applied the hedge accounting measurement and recognition requirements of IFRS 9 from 1 April 2018. The hedge relationships that qualified as hedges under IAS 39 also meet the hedging criteria under IFRS 9. These arrangements are regarded as continuing hedge relationships with no net transition adjustment to equity.
- The Company has one arrangement accounted for as a fair value hedge under IFRS 9 which previously did not qualify as a hedge under IAS 39. A fixed to floating rate interest rate swap was de-designated from a fair value hedge relationship in December 2017 when it failed to meet the hedging criteria of IAS 39. This instrument was re-designated as a fair value hedge from 1 April 2018 following the introduction of new hedging criteria under IFRS 9. The resulting hedge adjustment for the year ended 31 March 2019 was a £0.1m fair value gain to profit or loss against the carrying amount of the bonds (the hedged item in the fair value hedge relationship).

The accounting policy for financial instruments below has been revised to take into account the relevant changes resulting from the transition to the recognition and measurement provisions of IFRS 9 (FRS 102 11.2c).

Financial assets and financial liabilities are initially recognised at fair value, when the Company becomes a party to the contractual provisions of the instrument. Subsequent measurement is either at amortised cost or fair value depending on the classification of the instrument. Although IFRS 9 has introduced new requirements for the classification and measurement of financial assets and liabilities, the measurement at amortised cost or fair value remains the same as it was under IAS 39 (FRS 102 11.2b) for the Company's financial instruments.

Amortised cost is calculated as:

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

Less: The principal repayments;

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

Less: Any loss allowance in respect of financial assets.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is a quoted price in an active market. When quoted prices are unavailable, the price of a recent transaction for a similar asset provides evidence of fair value as long as there has not been a significant change in economic circumstances or a significant lapse of time since the transaction took place. If the market is not active and recent transactions of a similar asset on their own are not a good estimate of fair value, the fair value is estimated using a discounted cash flow approach.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

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

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

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

\* Derivatives and hedging accounting are discussed in subsequent paragraphs.

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

Cash and cash equivalents comprise cash in hand, and demand deposits and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

**Financial liabilities and equity***Equity instruments*

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

*Financial liabilities*

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

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

\* Derivatives and hedging accounting are discussed in subsequent paragraphs.

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

**Offsetting of financial instruments**

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

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

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

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

**Derivative financial instruments**

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

Interest rate and cross currency swaps are entered into for the purpose of managing the interest rate and currency risk associated with the borrowing requirements of the Company. Inflation linked swaps are used to economically hedge the exposure of the Company's regulated revenues to movements in inflation. Amounts payable or receivable in respect of the swap instruments are recognised within net finance costs in the profit and loss account.

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

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

**Hedge accounting**

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

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

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



## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

**2 Accounting policies (continued)****Hedge accounting continued***Cash flow hedges*

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

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

*Fair value hedges*

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

**3 Critical accounting judgements and key sources of estimation uncertainty**

In the application of the Company's accounting policies, which are described in note 2, the Directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The following paragraphs consider the critical judgements and key sources of estimation uncertainty that may have a significant effect on the amounts recognised in the financial statements.

**Critical judgements in applying the Company's accounting policies**

In the course of preparing the financial statements, the Directors do not consider that any judgements have been made in the process of applying the Company's accounting policies, other than those involving estimations (which are dealt separately with below), that have had a significant effect on the amounts recognised in the financial statements.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

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

## Key sources of estimation uncertainty

*Valuation of defined benefit obligation*

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

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

Details of the defined benefit schemes and the assumptions used to estimate the defined benefit obligation are set out in note 19. The sensitivity analysis below indicates how changes in the significant assumptions might affect the amount of pension obligations recognised at 31 March 2019.

	Change in assumption	Impact on scheme liabilities	
		UKPN Grp 2019 £m	UKPNPS 2019 £m
Discount rate	+/- 0.50%	-7.5% to +8.3%	-15.8% to +18.9%
RPI inflation	+/- 0.50%	+7.5% to -6.8%	+14.3% to -12.8%
Life expectancy	+/- 3 years	+13.2% to -13.1%	+13.2% to -13.2%
Rate of salary increases	+/- 0.50%	+0.9% to -0.8%	+4.8% to -4.2%

## 4 Turnover

Turnover, which is stated net of value added tax, arises entirely in the United Kingdom and is attributable to the continuing activity of electricity distribution and the invoice value of other goods and services provided. This includes an estimate of the sales value of units distributed to customers between the date of the last meter reading and the year end. It also includes the annual impact of contributions from customers towards the cost of connections to the network. This income is amortised to turnover over the expected useful lives of the related network assets. During the year this amounted to £39.7m (2018: £37.7m).

## EASTERN POWER NETWORKS PLC

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

#### 5 Operating profit

Arrived at after charging:

	2019 £ m	2018 £ m
Depreciation of tangible fixed assets	132.4	129.4
Amortisation of intangible assets	12.5	11.3
Operating lease rentals - land and buildings	0.5	0.5
Loss on disposal of property, plant and equipment	<u>0.2</u>	<u>0.9</u>

#### Auditor's remuneration

The amount payable to Deloitte LLP was £63,000 (2018: £43,600) in respect of audit services and £44,500 (2018: £58,700) in respect of non audit services. The non audit services relate to the review of the Company's interim results and assurance services for regulatory compliance.

#### Staff costs

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

#### 6 Directors' remuneration

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

##### Directors' remuneration

	2019 £	2018 £
Emoluments	<u>90,000</u>	<u>82,500</u>

##### Remuneration of highest paid director

	2019 £	2018 £
Emoluments	<u>45,000</u>	<u>41,250</u>

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

# EASTERN POWER NETWORKS PLC

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

### 7 Finance costs (net)

	2019 £ m	2018 £ m
Interest payable and similar expenses	(79.4)	(86.1)
Less: investment income	4.2	3.9
Other finance (costs)/income	<u>(26.2)</u>	<u>7.0</u>
	<u><u>(101.4)</u></u>	<u><u>(75.2)</u></u>

	2019 £ m	2018 £ m
<b>Investment income</b>		
Income from other fixed asset investments	0.1	0.1
Interest receivable on Group loans	3.9	3.7
Other interest receivable and similar income	<u>0.2</u>	<u>0.1</u>
	<u><u>4.2</u></u>	<u><u>3.9</u></u>

	2019 £ m	2018 £ m
<b>Interest payable and similar expenses</b>		
Interest on bank loans	(7.2)	(6.1)
Interest on bonds	(72.7)	(72.5)
Accretion on index linked debt	(3.7)	(5.4)
Interest payable on Group loans	-	(0.2)
Net interest on swap instruments	17.5	18.5
Accretion on swap instruments	<u>(15.4)</u>	<u>(22.6)</u>
	<u>(81.5)</u>	<u>(88.3)</u>
Finance costs capitalised	<u>2.1</u>	<u>2.2</u>
	<u><u>(79.4)</u></u>	<u><u>(86.1)</u></u>

Finance costs have been capitalised to tangible fixed assets on the basis of a capitalisation rate of 4.9% (2018: 5.2%), which is the weighted average of interest rates applicable to the Company's general borrowings during the period. The cumulative amount of interest capitalised within the cost of tangible fixed assets amounts to £43.0m (2018: £40.9m).

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

## 7 Finance costs (net) (continued)

	2019 £ m	2018 £ m
<b>Other finance (costs)/income</b>		
<b>Fair value (losses)/gains on financial instruments</b>		
Interest rate swaps not in hedge relationships	-	(3.0)
Index linked swaps not in hedge relationships	(29.7)	13.3
Interest rate swaps in fair value hedge relationships	(1.0)	(10.9)
Hedged items in fair value hedge relationships	0.9	8.6
Exchange gains on cross currency swap	0.9	-
Exchange losses on JPY bond hedged by cross currency swap	(0.9)	-
Change in fair value of cost of hedging through profit or loss	(0.4)	-
	<u>(30.2)</u>	<u>8.0</u>
<b>Amortisation of hedging adjustments</b>		
Amortisation of fair value hedge adjustments	5.1	1.3
Reclassified to profit or loss from hedge reserve	-	(0.5)
Amortisation of novation adjustment on index linked swaps	0.6	0.6
	<u>0.6</u>	<u>0.6</u>
Net (loss)/gain related to derivative financial instruments	(24.5)	9.4
<b>Other costs</b>		
Net interest on defined benefit pension liabilities	(1.5)	(2.4)
Other charges	(0.2)	-
	<u>(26.2)</u>	<u>7.0</u>

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

**8 Taxation**

Tax charged/(credited) to the profit and loss account

	2019 £ m	2018 £ m
<b>Current taxation</b>		
UK corporation tax	34.7	33.3
Adjustments in respect of prior years	(0.3)	2.1
Changes to Group losses for prior years <sup>1</sup>	23.8	-
Total current taxation	58.2	35.4
<b>Deferred taxation</b>		
Origination and reversal of timing differences	3.1	9.6
Adjustments in respect of prior years	0.3	(1.5)
Deferred tax provision movements <sup>1</sup>	(22.9)	3.3
Total deferred taxation	(19.5)	11.4
Total tax charge	38.7	46.8

The total tax assessed for the year was higher (2018: higher) than the standard rate of 19% (2018: 19%) applied to profit before tax. The differences are reconciled below:

	2019 £ m	2018 £ m
Profit before tax	201.0	232.1
Corporation tax at standard rate	38.2	44.1
Deferred tax credit due to tax rate changes	(0.4)	(1.2)
Adjustments to current tax in respect of prior years	(0.3)	2.1
Adjustments to deferred tax in respect of prior years	0.3	(1.5)
Changes to Group losses for prior years <sup>1</sup>	23.8	-
Deferred tax provision movements <sup>1</sup>	(22.9)	3.3
Total tax charge	38.7	46.8

<sup>1</sup> During the year a net current tax charge of £23.8m arose in connection with changes to group losses utilised in prior years. This was offset by the release of £22.9m from the deferred tax provision. The net effect of these transactions was to increase the total tax charge by £0.9m.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

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

The Finance Act 2016 enacted a reduction in the UK Corporation tax rate from 19% to 17% with effect from 1 April 2020.

The current tax rate applied during the year was 19% (2018: 19%) and deferred tax was calculated at 17% (2018: 17%) based on the standard rate of corporation tax substantively enacted at the reporting date.

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

	£ m
<b>Cost</b>	
At 1 April 2018	82.5
Additions	<u>10.2</u>
At 31 March 2019	<u>92.7</u>
<b>Amortisation</b>	
At 1 April 2018	36.6
Charge for the year	<u>12.5</u>
At 31 March 2019	<u>49.1</u>
<b>Net book value</b>	
<b>At 31 March 2019</b>	<u><u>43.6</u></u>
At 31 March 2018	<u><u>45.9</u></u>

# EASTERN POWER NETWORKS PLC

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

### 10 Tangible assets

	Network £ m	Non-network land and buildings £ m	Motor vehicles £ m	Furniture, fixtures and equipment £ m	Total £ m
<b>Cost</b>					
At 1 April 2018	6,496.2	35.0	8.7	102.8	<b>6,642.7</b>
Additions	350.9	3.4	-	3.8	<b>358.1</b>
Disposals	(17.6)	-	(1.4)	-	<b>(19.0)</b>
<b>At 31 March 2019</b>	<b><u>6,829.5</u></b>	<b><u>38.4</u></b>	<b><u>7.3</u></b>	<b><u>106.6</u></b>	<b><u>6,981.8</u></b>
<b>Depreciation</b>					
At 1 April 2018	1,894.7	4.8	8.0	85.9	<b>1,993.4</b>
Charge for the year	125.6	0.6	0.4	5.8	<b>132.4</b>
Eliminated on disposal	(17.1)	-	(1.4)	-	<b>(18.5)</b>
<b>At 31 March 2019</b>	<b><u>2,003.2</u></b>	<b><u>5.4</u></b>	<b><u>7.0</u></b>	<b><u>91.7</u></b>	<b><u>2,107.3</u></b>
<b>Net book value</b>					
<b>At 31 March 2019</b>	<b><u>4,826.3</u></b>	<b><u>33.0</u></b>	<b><u>0.3</u></b>	<b><u>14.9</u></b>	<b><u>4,874.5</u></b>
At 31 March 2018	<u>4,601.5</u>	<u>30.2</u>	<u>0.7</u>	<u>16.9</u>	<u>4,649.3</u>

Network assets include land with a book value of £24.8m (2018: £24.5m) and assets in the course of construction of £44.9m (2018: £40.7m). Approximately £16.0m of the prior year's assets under construction were completed during the current year.

Non-network land and buildings comprises freehold buildings only.

The cost of connecting customers to the network is included within network assets above. Capital contributions received from customers as payment for connections work are credited to the balance sheet as deferred income and released to profit or loss over the expected useful life of the related assets. During the year income of £39.7m (2018: £37.7m) was recognised within turnover in respect of customer contributions.



# EASTERN POWER NETWORKS PLC

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

### 11 Debtors

	Note	2019 £ m	2018 £ m
<b>Amounts falling due within one year:</b>			
Trade debtors		71.2	69.2
Amounts owed by Group undertakings		1.0	1.1
Other debtors		0.1	0.1
Prepayments and accrued income		3.7	4.2
		<u>76.0</u>	<u>74.6</u>
<b>Amounts falling due after more than one year:</b>			
Amounts owed by Group undertakings		144.5	144.5
Derivative financial assets	15	52.5	53.5
		<u>197.0</u>	<u>198.0</u>
		<u>273.0</u>	<u>272.6</u>

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

Amounts owed by Group undertakings due after more than one year comprise a loan of £144.5m to the parent company UK Power Networks Holdings Limited, bearing interest at 2.56% and due for repayment in June 2021.

# **EASTERN POWER NETWORKS PLC**

## **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019**

### **12 Creditors**

	<b>Note</b>	<b>2019 £ m</b>	<b>2018 £ m</b>
<b>Amounts falling due within one year:</b>			
Borrowings	13	120.0	-
Trade creditors		0.1	0.1
Amounts owed to Group undertakings		39.7	9.7
Corporation tax		7.6	29.7
Other taxation and social security		29.8	31.4
Other creditors		1.2	1.2
Accruals and deferred income		192.9	195.5
		<u>391.3</u>	<u>267.6</u>
<b>Amounts falling due after one year:</b>			
Borrowings	13	1,701.1	1,749.0
Deferred income		1,114.3	1,054.0
Derivative financial liabilities	15	326.0	280.0
		<u>3,141.4</u>	<u>3,083.0</u>

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

Deferred income falling due after one year comprises contributions received from customers as payment for connections work, the cost of which is capitalised to network assets. This income is released to turnover over the expected useful lives of the related network assets. Accruals and deferred income falling due within one year includes £42.2m (2018: £39.6m) of deferred income relating to customer contributions, expected to be released to turnover within one year.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

## 13 Borrowings

	2019 £ m	2018 £ m
<b>Amounts due within one year</b>		
Amounts due to Group undertakings	40.0	-
£80m 2.35% EIB loan due January 2020	80.0	-
	<u>120.0</u>	<u>-</u>
<b>Amounts falling due after more than one year</b>		
£80m 2.35% EIB loan due January 2020	-	80.0
£50m 0.01% Index linked EIB loan due November 2024	55.5	54.1
£15m 2.335% EIB loan due October 2025	15.0	15.0
£130m 2.234% EIB loan due March 2028	130.0	130.0
£35m 1.614% EIB loan due October 2028	35.0	35.0
£50m 2.224% EIB loan due February 2030	50.0	50.0
£400m 4.75% Bond due September 2021	401.4	401.9
£350m 5.75% Bond due March 2024	349.7	349.6
£40m 0.25% Index Linked bond due February 2025	44.3	43.1
£35m 0.032% Index Linked bond due October 2025	39.0	37.9
£132.3m 8.5% Bond due March 2025	131.8	131.7
£350m 6.25% Bond due November 2036	345.4	345.2
£33.8m 1.035% JPY Bond due July 2038	33.6	-
Exchange loss adjustment on JPY bond	0.9	-
Adjustments for fair value hedge relationships	69.5	75.5
	<u>1,701.1</u>	<u>1,749.0</u>
	<u>1,821.1</u>	<u>1,749.0</u>

Amounts due to Group undertakings within one year comprise a loan of £20.0m from London Power Networks plc and a loan of £20.0m from UK Power Networks Operations Ltd, both carrying interest at 1.0%.

Borrowings are stated net of unamortised issue costs of £5.8m (2018: £6.1m) and include an unamortised net premium of £1.4m (2018: £1.9m) on the 4.75% bond and accretion of £14.0m (2018: £10.4m) on the index linked instruments. These balances together with the interest expense are allocated to the profit and loss account over the term of the debt.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

**13 Borrowings (continued)**

The cumulative adjustment to the carrying amount of the bonds, arising from fair value hedge relationships with interest rate swaps, amounts to £69.5m (2018: £75.5m). This is presented on a separate line in the table above. The movement during the year comprises a fair value gain of £0.9m (2018: gain of £8.6m) relating to existing fair value hedge relationships and an amortisation adjustment of £5.1m (2018: £1.3m) relating to discontinued hedge relationships. The fair value adjustment amortises to profit or loss from the date of cessation of the fair value hedge until the maturity of the previously hedged debt.

In July 2018 the Company issued a 20 year fixed rate bond for JPY 5 billion with a fixed coupon of 1.035% and maturing in July 2038. Simultaneously a fixed rate GBP cross currency swap with the same nominal value and maturity was traded to hedge the exchange rate exposure on the bond. The resulting net fixed coupon is 2.972% per annum payable semi-annually. Proceeds from the issue comprised a nominal value of £33.8m net of finance fees of £0.1m.

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

**Borrowing facilities**

The Company has access to an undrawn credit facility of £105.0m until March 2022.

**14 Financial instruments**

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

	Note	2019 £ m	2018 £ m
<b>Financial assets</b>			
<b>Measured at fair value through profit or loss</b>			
Derivative financial assets	15	-	30.8
<b>Measured at fair value and designated in an effective hedge relationship</b>			
Derivative financial assets	15	52.5	22.7
<b>Measured at amortised cost</b>			
Loans receivable from Group undertakings	11	144.5	144.5
Trade and other debtors, excluding prepayments and accrued income	11	72.3	70.4
		<u>269.3</u>	<u>268.4</u>

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

## 14 Financial instruments (continued)

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

		2019 £m	2018 £m
<b>Financial liabilities</b>			
<b>Measured at fair value through profit or loss</b>			
Derivative financial liabilities	15	(324.6)	(280.0)
<b>Measured at fair value and designated in an effective hedge relationship</b>			
Derivative financial liabilities		(1.4)	-
<b>Measured at amortised cost and designated in an effective hedge relationship</b>			
* Bonds	13	(415.6)	(219.4)
<b>Measured at amortised cost</b>			
**Bonds and loans payable	13	(1,405.5)	(1,529.6)
Trade and other payables, excluding taxation and social security and accruals and deferred income	12	(41.0)	(11.0)
		<u>(2,188.1)</u>	<u>(2,040.0)</u>

\* The carrying value of bonds measured at amortised cost and designated in an effective hedge relationship includes a fair value adjustment of £69.5m (2018: £39.6m) relating to fair value hedges and £0.9m (2018: £nil) relating to a cashflow hedge.

\*\* The carrying value of bonds measured at amortised cost at 31 March 2018 includes a fair value adjustment of £35.9m relating to a discontinued fair value hedge relationship.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

**14 Financial instruments (continued)**

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

	2019 £ m	2018 £ m
<b>Derivative financial assets measured at fair value through profit or loss</b>		
Interest rate swaps not in hedge relationships		
- Net interest receivable	-	1.5
- Fair value losses	-	(3.9)
<b>Derivative financial assets measured at fair value and designated in effective hedge relationships</b>		
Interest rate swaps designated as fair value hedges		
- Net interest receivable	8.8	8.8
- Fair value losses	(1.0)	(10.9)
<b>Financial assets measured at amortised cost</b>		
- Interest receivable on Group loans	3.9	3.7
	<u>11.7</u>	<u>(0.8)</u>

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

**14 Financial instruments (continued)**

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

	2019 £ m	2018 £ m
<b>Derivative financial liabilities measured at fair value through profit or loss</b>		
Interest rate swaps not in hedge relationships		
- Net interest payable	-	(0.9)
- Fair value gains	-	0.9
Index linked swaps not in hedge relationships		
- Net interest receivable	9.1	9.1
- Accretion payable	(15.4)	(22.6)
- Fair value (losses)/gains	(29.7)	13.3
<b>Derivative financial liabilities measured at fair value and designated in effective hedge relationships</b>		
Interest rate swaps designated as cash flow hedges		
- Net interest payable	(0.4)	-
- Fair value losses deferred to hedge reserves	(1.4)	-
- Change in fair value of cost of hedging through profit or loss	(0.4)	-
- Exchange gains through profit or loss	0.9	-
<b>Financial liabilities which are hedged items in effective hedge relationships</b>		
JPY bond hedged by cross currency swap		
- Net Interest payable	(0.3)	-
- Exchange losses measured through profit or loss	(0.9)	-
Bonds in fair value hedge relationships		
- Fair value gains measured through profit or loss	0.9	8.6
<b>Financial liabilities measured at amortised cost</b>		
Interest payable on bonds and bank loans	(79.6)	(78.6)
Accretion payable on bonds and bank loans	(3.7)	(5.4)
Interest payable on Group loans	-	(0.2)
	<u>(120.9)</u>	<u>(75.8)</u>

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

## 15 Derivative financial instruments

	2019 £ m	2018 £ m
<b>Derivative financial assets</b>		
<b>Amounts falling due after more than one year</b>		
Interest rate swaps designated as effective fair value hedges	52.5	22.7
Interest rate swaps not designated in hedging relationships	-	30.8
	<u>52.5</u>	<u>53.5</u>
<b>Derivative financial liabilities</b>		
<b>Amounts falling due after more than one year</b>		
Interest rate swaps designated as effective cash flow hedges	(1.4)	-
Index linked swaps not designated in hedging relationships	(324.6)	(280.0)
	<u>(326.0)</u>	<u>(280.0)</u>
	<u>(273.5)</u>	<u>(226.5)</u>

Interest rate swaps and cross currency swaps are used to manage the interest rate risk and exchange rate risk on the Company's borrowings and index linked swaps are used to partially hedge the RPI exposure on the Company's regulated income.

Under interest rate swap contracts, the Company agrees to exchange the difference between fixed and floating rate interest calculated on agreed notional principal amounts. A cross currency swap contract exchanges JPY amounts due on the JPY bond with sterling values. Index linked contracts convert floating or fixed interest rates to RPI inflation linked rates.

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

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



## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

## 15 Derivative financial instruments (continued)

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

## Fair value hedge interest rate swaps

	Average contract fixed interest rate		Notional principal value		Fair value	
	2019	2018	2019	2018	2019	2018
	%	%	£ m	£ m	£ m	£ m
<b>Maturity of outstanding contracts</b>						
<b>Receive fixed / pay floating</b>						
2 to 5 years	5.8%	5.8%	180.0	180.0	21.8	22.7
5 years plus	8.5%	-	132.3	-	30.7	-
			<u>312.3</u>	<u>180.0</u>	<u>52.5</u>	<u>22.7</u>

The fair value hedge interest rate swaps exchange fixed rate interest for floating rate interest as a hedge against the fair value risk on part of the Company's bond debt. The floating rate payable is six month LIBOR plus a margin of between 2.1% and 4.8% with maturation dates from 2024 to 2025.

These swaps were assessed as effective as fair value hedges throughout the current financial year but in the prior year from 1 January 2018 to 31 March 2018 the contracts converting an 8.5% fixed rate to a floating rates on a nominal value of £132.3m were assessed as ineffective under the hedging rules of IAS 39, de-designated from the fair value hedge relationship and reclassified as non-hedges. These instruments were re-designated as a fair value hedge from 1 April 2018 following the introduction of new hedging criteria under IFRS 9.

Fair value losses of £1.0m (2018: losses of £10.9m) on the swaps were recognised in profit or loss during the year offset by fair value gains of £0.9m (2018: gains of £8.6m) adjusted to the carrying amount of the bonds as part of the hedge relationship. The fair value adjustment relating to the discontinued hedge relationship began amortising to profit or loss from the date the hedge became ineffective on 1 January 2018. The resulting amortisation adjustment was a gain of £5.1m (2018: gain of £1.3m) to profit or loss in the year.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

## 15 Derivative financial instruments (continued)

## Cash flow hedge interest rate swaps

	Average contract fixed interest rate		Notional principal value		Fair value	
	2019	2018	2019	2018	2019	2018
	%	%	£ m	£ m	£ m	£ m
<b>Maturity of outstanding contracts</b>						
<b>Receive fixed USD rate / pay fixed sterling rate</b>						
5 years plus	3.0%	-	<u>33.8</u>	<u>-</u>	<u>(1.4)</u>	<u>-</u>

In July 2018 the Company transacted a cross currency swap to hedge the exchange rate exposure on the JPY 5 billion bond issued on the same date. The swap is designated as an effective cash flow hedge, exchanging the JPY principal and the JPY interest payments with equivalent values in Sterling until the maturity of the bond in July 2028.

During the year losses of £1.4m (2018: £nil) were deferred to the cash flow hedge reserve and losses of £0.4m deferred to the cost of hedging reserve (refer to note 17 for further detail). In addition, costs of hedging of £0.4m (2018: £nil) were charged to profit or loss.

## Non hedge interest rate swaps

	Average contract fixed interest rate		Notional principal value		Fair value	
	2019	2018	2019	2018	2019	2018
	%	%	£ m	£ m	£ m	£ m
<b>Maturity of outstanding contracts</b>						
<b>Receive fixed / pay floating</b>						
5 years plus	-	8.5%	<u>-</u>	<u>132.3</u>	<u>-</u>	<u>30.8</u>

## Received fixed/pay floating contracts held at 31 March 2018

The fixed to floating rate contracts presented above were de-designated from a fair value hedge relationship from 1 January 2018 to 31 March 2018 after failing to meet the hedging criteria of IAS 39. The fair value hedge relationship was reinstated from 1 April 2018 following the introduction of new hedging criteria under IFRS 9. Therefore at 31 March 2019 these instruments are presented as fair value hedges on page 55.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

## 15 Derivative financial instruments (continued)

## Non hedge index linked swap contracts

	Average contract fixed interest rate		Notional principal value		Fair value	
	2019 %	2018 %	2019 £ m	2018 £ m	2019 £ m	2018 £ m
<b>Maturity of outstanding contracts</b>						
<b>Receive fixed / pay fixed + RPI</b>						
5 years plus	6.0%	6.0%	320.0	320.0	(166.7)	(137.3)
<b>Receive floating / pay fixed + RPI</b>						
5 years plus	-	-	150.0	150.0	(157.9)	(142.7)
			<u>470.0</u>	<u>470.0</u>	<u>(324.6)</u>	<u>(280.0)</u>

The Company uses RPI linked swap contracts to convert a portion of the fixed rate bond interest payable to an inflation linked rate. Although designed as an economic hedge against the RPI exposure of the Company's regulated income, these instruments are not designated in formal hedge accounting relationships. The index linked swaps receive a combination of fixed and floating rate interest and pay RPI linked interest. Maturities range from November 2036 to December 2041.

During the year fair value losses of £29.7m (2018: gains of £13.3m) were recognised in profit or loss together with an accretion charge of £15.4m (2018: £22.6m) and interest receivable of £9.1m (2018: £9.1m).

## 16 Provisions for liabilities

	2019 £ m	2018 £ m
Provision for deferred tax	174.8	190.2
Other provisions	<u>14.6</u>	<u>12.7</u>
	<u>189.4</u>	<u>202.9</u>
<b>Defined benefit retirement obligations</b>		
UKPN Group of the ESPS (UKPN Group Scheme)	8.6	37.6
UK Power Networks Pension Scheme (UKPNPS)	<u>32.3</u>	<u>34.0</u>
	<u>40.9</u>	<u>71.6</u>
	<u>230.3</u>	<u>274.5</u>

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

**16 Provisions for liabilities (continued)**

Movements in the defined benefit pension schemes are detailed in note 19. Movements in the deferred tax provisions and other provisions are shown below:

	Deferred tax £ m	Other provisions £ m	Total £ m
At 1 April 2018	190.2	12.7	202.9
(Credited)/charged to profit or loss	(19.5)	1.9	(17.6)
Charged to other comprehensive income	4.1	-	4.1
<b>At 31 March 2019</b>	<b>174.8</b>	<b>14.6</b>	<b>189.4</b>

**Explanation of provisions**

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

**Analysis of deferred tax**

	2019 £ m	2018 £ m
Accelerated capital allowances	232.5	224.9
Deferred tax relating to defined benefit pension schemes	(7.0)	(12.2)
Other timing differences	(50.7)	(22.5)
<b>Net deferred tax liability</b>	<b>174.8</b>	<b>190.2</b>

**17 Called up share capital and reserves****Share capital: Allotted, called up and fully paid**

	2019 £ m	2018 £ m
251,513,142 ordinary shares at £0.50 each	125.8	125.8

**Reserves**

The share premium reserve contains the premium arising on issue of equity shares, net of issue expenses. The capital redemption reserve represents the value of historical repurchases of the Company's own capital.

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

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

## 17 Called up share capital and reserves (continued)

## Hedging reserves

*Cash flow hedge reserve*

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

*Cost of hedging reserve*

In July 2018 the Company entered into a cross currency swap to hedge the foreign currency risk on the JPY denominated bond, within a designated cash flow hedge relationship.

In the valuation of cross currency interest rate swaps, spreads are applied to cash flows in currencies with perceived higher credit risk or lower liquidity. These are referred to as "currency basis spreads". As they only exist in the hedging instrument (the cross currency swap), IFRS 9 (within FRS 102 11.2c) does not allow inclusion of the currency basis spreads in the valuation of the hedged item (the foreign currency risk of the bond), in the assessment of hedge effectiveness. Due to this mismatch between the hedging instrument and the hedged item, fair value changes in these currency basis spreads lead to hedge ineffectiveness.

IFRS 9 (within FRS 102 11.2c) allows for the fair value changes in the currency basis spreads to be recorded in a separate cost of hedging reserve, through other comprehensive income, to the extent those changes are aligned with the hedged item. Excluding these movements from the hedge relationship helps to increase hedge effectiveness and mitigate volatility in profit or loss.

Movements in the hedging reserves in the current and prior year are shown below net of deferred tax:

	Cash flow hedge reserve £ m	Cost of hedging reserve £ m	Hedging reserves £ m
<b>At 1 April 2017</b>	<b>(0.4)</b>	<b>-</b>	<b>(0.4)</b>
Reclassified to profit or loss net of deferred tax	<u>0.4</u>	<u>-</u>	<u>0.4</u>
<b>At 31 March 2018</b>	<b>-</b>	<b>-</b>	<b>-</b>
Fair value losses net of deferred tax	(1.1)	-	(1.1)
Reclassified to profit or loss net of deferred tax	<u>-</u>	<u>(0.4)</u>	<u>(0.4)</u>
<b>At 31 March 2019</b>	<b><u>(1.1)</u></b>	<b><u>(0.4)</u></b>	<b><u>(1.5)</u></b>

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

**18 Commitments and contingencies**

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

**Capital commitments**

Amounts contracted for but not provided in the financial statements amounted to £56.4m (2018: £43.2m).

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

	<b>2019</b>	2018
	<b>£ m</b>	£ m
<b>Land and buildings</b>		
- within one year	<b>0.5</b>	0.5
- between one and five years	<b>1.9</b>	1.9
- after five years	<b>9.6</b>	9.5
	<b>12.0</b>	11.9

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

**19 Pension commitments**

**Defined benefit pension schemes**

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

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

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

**The UK Power Networks Pension Scheme (UKPNPS)**

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

Funding levels are monitored annually and a funding schedule is formally agreed between the Group and the scheme trustees every three years based on the most recent triennial actuarial valuation. The current funding schedule is based on the actuarial valuation as at 31 March 2016. The agreed contribution rates are considered sufficient to eliminate the current deficit over the next five years.

A valuation under FRS 102 at the balance sheet date was provided by actuaries using rolled forward member data from the 31 March 2016 triennial valuation and reflecting updated financial and demographic assumptions. The defined benefit scheme assets and liabilities are assigned to participating entities using an allocation methodology based on employment records and attribution portions agreed with the industry regulator Ofgem.

The next triennial valuation as at 31 March 2019 was in progress at the time of approval of these financial statements.

At the end of March 2019, 323 members of the Carillion Group of the ESPS were transferred to the UKPN Group of the ESPS at which time the UKPN Group took on the obligation to pay the benefits these members had built up in the Carillion Group of the ESPS. At 31 March 2019 this defined benefit obligation was valued at £82.0m and the fair value of assets acquired on transfer was £84.0m, resulting in a net credit to other comprehensive income of £2.0m.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

**19 Pension commitments (continued)**

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

	2019 %	2018 %
<b>UKPN Group key financial assumptions</b>		
Discount rate	2.5	2.7
Future salary increases	3.7	3.6
RPI inflation	3.2	3.1
CPI inflation	2.1	2.0
Pension increases in deferment	3.2	3.1
Pension increases in payment		
- pensions in excess of GMP	3.2	3.1
- post-88 GMP	1.9	1.8

	2019 %	2018 %
<b>UKPNPS key financial assumptions</b>		
Discount rate	2.5	2.6
Future salary increases	3.6	3.5
RPI inflation	3.1	3.0
CPI inflation	2.0	1.9
Pension increases in deferment		
- CPI up to 5% per annum	2.0	1.9
- CPI up to 2.5% per annum	2.0	1.9
Pension increases in payment		
- RPI up to 5% per annum	3.0	2.9
- RPI up to 2.5% per annum	2.1	2.1
- post-88 GMP	1.8	1.7



# EASTERN POWER NETWORKS PLC

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

### 19 Pension commitments (continued)

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

	2019 Years	2018 Years
<b>UKPN Group life expectancy assumptions</b>		
Current male pensioner aged 60	26	27
Current female pensioner aged 60	28	29
Future male pensioner from age 60 retiring in 2039	28	29
Future female pensioner from age 60 retiring in 2039	<u>30</u>	<u>31</u>

	2019 Years	2018 Years
<b>UKPNPS life expectancy assumptions</b>		
Current male pensioner aged 65	22	23
Current female pensioner aged 65	24	25
Future male pensioner from age 65 retiring in 2039	23	25
Future female pensioner from age 65 retiring in 2039	<u>26</u>	<u>27</u>

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

	UKPN Grp 2019 £ m	UKPNPS 2019 £ m	Total 2019 £ m	Total 2018 £ m
Fair value of scheme assets	682.1	126.3	808.4	684.6
Present value of defined benefit obligation	<u>(690.7)</u>	<u>(158.6)</u>	<u>(849.3)</u>	<u>(756.2)</u>
Defined benefit pension scheme deficit	<u>(8.6)</u>	<u>(32.3)</u>	<u>(40.9)</u>	<u>(71.6)</u>

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

**19 Pension commitments (continued)**

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

	UKPN Grp 2019 £ m	UKPNPS 2019 £ m	Total 2019 £ m	Total 2018 £ m
Current service cost	(12.9)	(7.2)	(20.1)	(21.8)
Past service cost	(1.8)	-	(1.8)	(0.4)
Net interest cost	(0.9)	(0.6)	(1.5)	(2.4)
	(15.6)	(7.8)	(23.4)	(24.6)
Recognised in other comprehensive income	22.7	2.9	25.6	18.9
	7.1	(4.9)	2.2	(5.7)

Of the charge for the year an expense of £21.9m (2018: £22.2m) has been included in distribution costs and an expense of £1.5m (2018: £2.4m) included within net finance costs.

**Guaranteed Minimum Pension ("GMP") equalisation**

GMP is a portion of pension that was accrued by individuals who were contracted out of the State Second Pension prior to 6 April 1997. Historically there was an inequality of benefits between male and female members who have GMP. A High Court case concluded in October 2018 which confirmed that GMPs need to be equalised. The past service cost presented in the table above includes an allowance of £1.4m for the potential cost of equalising GMP between males and females within the UKPN Group scheme.

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

	UKPN Grp 2019 £ m	UKPNPS 2019 £ m	Total 2019 £ m	Total 2018 £ m
At 1 April	(610.6)	(145.6)	(756.2)	(736.9)
Current service cost	(12.9)	(7.2)	(20.1)	(21.8)
Past service cost	(1.8)	-	(1.8)	(0.4)
Interest cost	(16.1)	(3.7)	(19.8)	(19.5)
Actuarial gains/(losses)	3.9	(0.8)	3.1	(2.6)
Net increase in liabilities from bulk transfers	(82.0)	-	(82.0)	-
Benefits paid	28.8	(1.3)	27.5	25.0
At 31 March	(690.7)	(158.6)	(849.3)	(756.2)

The actuarial gain (2018: loss) includes a net transfer out of scheme liabilities amounting to £9.1m (2018: £33.8m transfer in) to align the allocation of scheme liabilities across the Group to the attribution portions agreed with Ofgem. The bulk transfer in of 323 members from the Carillion Group of the ESPS at the end of March 2019 has increased scheme liabilities by £82.0m.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

## 19 Pension commitments (continued)

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

	UKPN Grp 2019 £ m	UKPNPS 2019 £ m	Total 2019 £ m	Total 2018 £ m
At 1 April	573.0	111.6	684.6	642.8
Interest income	15.2	3.1	18.3	17.1
Return on plan assets (excluding amounts included in net interest cost)	16.8	3.7	20.5	21.5
Contributions by employer	10.3	5.0	15.3	15.4
Deficit repair payments	11.6	1.6	13.2	12.8
Net increase in assets from bulk transfers	84.0	-	84.0	-
Benefits (paid)/received	(28.8)	1.3	(27.5)	(25.0)
<b>At 31 March</b>	<b>682.1</b>	<b>126.3</b>	<b>808.4</b>	<b>684.6</b>

The return on plan assets (excluding amounts included in net interest cost) includes a net transfer out of scheme assets amounting to £7.0m (2018: £32.9m transfer in) to align the allocation of scheme assets across the Group to the attribution portions agreed with Ofgem. The bulk transfer in of 323 members from the Carillion Group of the ESPS at the end of March 2019 has increased scheme assets by £84.0m.

The fair value of scheme assets is analysed as follows:

	UKPN Grp 2019 £ m	UKPNPS 2019 £ m	Total 2019 £ m	Total 2018 £ m
Equities	148.4	55.3	203.7	168.5
Liability driven investments	224.8	41.3	266.1	211.6
Corporate bonds	0.5	11.7	12.2	11.4
Multi credit funds	50.5	-	50.5	49.6
Property	-	10.3	10.3	10.0
Hedge funds	-	6.0	6.0	6.3
Macro funds	61.2	-	61.2	67.9
Multi asset funds	145.7	-	145.7	155.4
Other	51.0	1.7	52.7	3.9
	<b>682.1</b>	<b>126.3</b>	<b>808.4</b>	<b>684.6</b>

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019

## 20 Notes to the cash flow statement

	2019 £ m	2018 £ m
Operating profit	302.4	307.3
<b>Adjustment for</b>		
Depreciation and amortisation of assets	144.9	140.7
Customer contributions recognised in turnover	(39.7)	(37.7)
Loss on disposal of tangible fixed assets	0.2	0.9
Operating cash flow before movement in working capital	407.8	411.2
Increase in debtors	(1.4)	(2.9)
Increase/(decrease) in creditors	23.1	(5.6)
Increase in provisions	1.9	1.1
Pension deficit repair payment	(13.2)	(12.8)
Pension adjustments	6.7	6.9
<b>Cash generated from operations</b>	<b>424.9</b>	<b>397.9</b>

Major non-cash flows in respect of pension schemes have been disclosed in note 19.

## 21 Related party transactions

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

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2019**

**22 Parent and ultimate parent undertaking**

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

Newington House  
237 Southwark Bridge Road  
London  
SE1 6NP

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

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

- Power Assets Holdings Limited, incorporated in Hong Kong;
- Li Ka Shing Foundation Limited, incorporated in Hong Kong; and
- CK Infrastructure Holdings Limited, incorporated in Bermuda.

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