Registration number: 03115179

Spirit Energy Production UK Limited

Annual Report and Financial Statements

for the Year Ended 31 December 2018

Spirit Energy Production UK Limited

Contents

Spirit Energy Production UK Limited

Strategic Report for the Year Ended 31 December 2018

The Directors present their Strategic Report for Spirit Energy Production UK Limited (the 'Company') for the year ended 31 December 2018.

Principal activities
The principal activities of the Company are the production of gas from the Rhyl North and South Morecambe gas fields.

Review of the business
The Company's major activity is the production of gas and associated condensate from its main production fields (Rhyl, North and South Morecambe) in Morecambe Bay. These fields represent proven and probable reserves of approximately 188 billion cubic feet of gas at 31 December 2018 (2017: 223 billion cubic feet). Production of gas amounted to 16 billion cubic feet (2017: 15 billion cubic feet) in the year with total condensate sales equivalent to 53,359 barrels of oil equivalent (2017: 49,000 barrels of oil equivalent).

Financial position
The financial position of the Company is presented in the Balance Sheet on page 11. Total equity at 31 December 2018 was £865,334,000 (2017: £924,330,000).

Key performance indicators (KPIs)
The performance of the Company is included in the consolidated results of Spirit Energy Limited (the 'Group'). The Directors of Spirit Energy Limited manage the Group on a divisional basis and use a number of KPIs to monitor progress against the Group's strategy. For this reason, the Company's Directors believe that analysis using KPIs for the Company is not necessary or appropriate for an understanding of the development, performance and position of the business of the Company. A discussion of the Group KPIs is on pages 3 and 4 of the Group's consolidated financial statements for the year ended 31 December 2018, which does not form part of this report and are available at the address detailed in note 26 of these financial statements.

Future developments
From the perspective of the Company, the future developments are integrated within those of the Group and are not managed separately. The future developments of the Group are disclosed on page 4 of the Group's consolidated financial statements for the year ended 31 December 2018, which does not form part of this report.

It is expected that the Company will continue with its principal activities of the production of gas from the Rhyl North and South Morecambe gas fields.

Principal risks and uncertainties
From the perspective of the Company, the principal risks and uncertainties are integrated with those of the Group and are not managed separately. The principal risks and uncertainties of the Group are disclosed on pages 5 and 6 of the Group's consolidated financial statements for the year ended 31 December 2018, which does not form part of this report.

Exit from the European Union
The UK referendum vote in June 2016 to leave the European Union has added to the risks and uncertainties faced by the Company. However, it is considered that the direct impact of these uncertainties on the Company is limited in the short term. Many details of the implementation process continue to remain unclear. Extricating from the European Union treaties is a task of immense complexity, but the Company has prepared itself to manage the possible impacts on its business. There are also potential tax consequences of the withdrawal and these will continue to be reassessed at each reporting date to ensure the tax provisions reflect the most likely outcome following the withdrawal.

Approved by the Board on 19 September 2019 and signed on its behalf by:

....

NJ McCulloch
Director
Company registered in England and Wales, No. 03115179

Registered office:

1st Floor
20 Kingston Road
Staines-Upon-Thames
England
TW18 4LG

Spirit Energy Production UK Limited

Directors' Report for the Year Ended 31 December 2018

The Directors present their report and the audited financial statements for the year ended 31 December 2018.

Directors of the Company

The Directors of the Company who were in office during the year, unless otherwise indicated, and up to the date of signing the financial statements were as follows:

PMR Tanner (resigned 31 May 2018)
TMK Lishman (resigned 31 December 2018)
AD Le Poidevin (resigned 31 May 2019)
GM Harrison
NJ Macleod (appointed 11 September 2018)
NJ McCulloch (appointed 1 January 2019)

Results and dividends

The results of the Company are set out on page 9. The loss for the financial year ended 31 December 2018 is £59,213,000 (2017: £42,891,000).

The Directors do not recommend the payment of a final dividend (2017: £nil).

Employees

During 2018, the Company employed an average of 494 people (2017: 263), all employed in the United Kingdom.

Employees are regularly updated on performance against the Company's strategy. There are regular employee surveys, action planning forums and dialogue with representatives of local employee consultative bodies and recognised trade unions to ensure a comprehensive understanding of employees' views. The Group, to which Spirit Energy Production UK Limited belongs, encourages employee share ownership by operating tax authority-approved share schemes open to all eligible employees, including Executive Directors.

The Company is committed to pursuing equality and diversity in all its employment activities and continues to support initiatives to provide employment for people from minority groups in the community, including people with a disability, carers and lone parents. To the extent possible, people with a disability are offered the same employment training, career development and promotion opportunities as other employees.

The Company's business principles and policies set out standards of behaviour expected of its employees in conducting business in an ethical way.

Future developments

Future developments are discussed in the Strategic Report on page 1.

Going concern

The financial statements have been prepared on a going concern basis as Spirit Energy Limited, the immediate parent company, currently intends to support the Company to ensure it can meet its obligations as they fall due, provided the Company remains a member of the Group. The Directors have received confirmation that Spirit Energy Limited intends to support the Company for at least one year after the financial statements have been authorised for issue.

Directors' insurance and indemnities

Spirit Energy Limited, the immediate parent company of the Company, maintains directors' and officers' liability insurance in respect of its Directors and those Directors of its subsidiary companies. Qualifying third-party indemnity provisions, as defined in S234 of the Companies Act 2006, were in force for the benefit of the Directors of the Company during the year and up to and including the date of the Directors' report.

Spirit Energy Production UK Limited

Directors' Report for the Year Ended 31 December 2018 (continued)

Disclosure of information to auditor

Each of the Directors who held office at the date of approval of this Directors' Report confirm that so far as they are aware, there is no relevant audit information of which the Company's auditor is unaware, and they have taken all steps that they ought to have taken as Directors 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 Section 418 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 forthcoming Board Meeting.

Approved by the Board on 19 September 2019 and signed on its behalf by:

NJ McCulloch
Director
Company registered in England and Wales, No. 03115179

Registered office:

1st Floor
20 Kingston Road
Staines-Upon-Thames
England
TW18 4LG

Spirit Energy Production UK Limited

Statement of Directors' Responsibilities for the Year Ended 31 December 2018

The Directors are responsible for preparing the Strategic Report, Directors' Report and the financial statements in accordance with applicable law and regulations..

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including Financial Reporting Standard 101 'Reduced Disclosure Framework' ('FRS 101'). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make 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 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.

Spirit Energy Production UK Limited

Independent Auditor's Report to the Members of Spirit Energy Production UK Limited

Report on the audit of the financial statements

Opinion
In our opinion the financial statements of Spirit Energy Production UK Limited (the 'Company'):

- give a true and fair view of the state of the Company's affairs as at 31 December 2018 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 101 'Reduced Disclosure Framework'; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the income statement;
- the statement of comprehensive income;
- the balance sheet;
- the statement of changes in equity; and
- the related notes 1 to 26.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 101 'Reduced Disclosure Framework' (United Kingdom Generally Accepted Accounting Practice).

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

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern
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 have nothing to report in respect of these matters.

Other information
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. 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.

We have nothing to report in respect of these matters.

Independent Auditor's Report to the Members of Spirit Energy Production UK Limited (continued)

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

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

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

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

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006
In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the 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
Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

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

We have nothing to report in respect of these matters.

Independent Auditor's Report to the Members of Spirit Energy Production UK Limited (continued)

Use of our report

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

G Hollis

Graham Hollis ACA (Senior Statutory Auditor)
For and on behalf of Deloitte LLP
Statutory Auditor

Union Plaza
1 Union Wynd
Aberdeen
AB10 1SL

19 September 2019

Spirit Energy Production UK Limited

Income Statement for the Year Ended 31 December 2018

	Note	2018 £ 000	2017 £ 000
Revenue	4	84,903	55,957
(Loss)/gain on remeasurement of derivatives	5	(12,243)	606
Cost of sales	6	(165,098)	(170,652)
Gross loss		(92,438)	(114,089)
Operating costs	6	(41,363)	(25,753)
Exceptional items - restructuring costs	8	-	(924)
Exceptional items - impairment charges	8	-	(270,815)
Operating loss		(133,801)	(411,581)
Finance income	10	4,692	43,802
Finance cost	10	(9,152)	(43,000)
Net finance (cost)/income		(4,460)	802
Loss before taxation		(138,261)	(410,779)
Tax credit	12	79,048	367,888
Loss for the year		(59,213)	(42,891)

The results in the above Income Statement relate to continuing operations.

Statement of Comprehensive Income for the Year Ended 31 December 2018

	2018 £ 000	2017 £ 000
Loss for the year	(59,213)	(42,891)
Other comprehensive income/(loss)		
Items that will be or have been reclassified to the Income Statement		
Net gain on cash flow hedges	57	-
Items that will not be reclassified to the Income Statement		
Net actuarial gains on defined benefit pension schemes	-	12,238
Remeasurements of post-employment benefit obligations	-	(4,894)
Other comprehensive income net of taxation	57	7,344
Total comprehensive loss for the year	(59,156)	(35,547)

Spirit Energy Production UK Limited

Balance Sheet as at 31 December 2018

	Note	2018 £ 000	2017 £ 000
Non-current assets			
Property, plant and equipment	13	357,432	343,491
Deferred tax assets	12	266,433	285,446
Other financial assets		-	275
Derivative financial instruments	25	1,736	-
		625,601	629,212
Current assets			
Trade and other receivables	14	764,545	823,959
Inventories	15	11,941	12,248
Income tax asset		74,750	67,462
Derivative financial instruments	25	1,309	875
Cash and cash equivalents		318	1,657
		852,863	906,201
Total assets		1,478,464	1,535,413
Current liabilities			
Trade and other payables	16	(52,548)	(50,713)
Derivative financial instruments	25	(11,827)	-
Provisions for other liabilities and charges	17	(65,127)	(34,373)
Borrowings	18	(15)	(15)
		(129,517)	(85,101)
Net current assets		723,346	821,100
Total asset less current liabilities		1,348,947	1,450,312
Non-current liabilities			
Derivative financial instruments	25	(2,788)	(250)
Provisions for other liabilities and charges	17	(480,707)	(525,584)
Borrowings	18	(118)	(148)
		(483,613)	(525,982)
Total liabilities		(613,130)	(611,083)
Net assets		865,334	924,330
Equity			
Share capital	20	800,000	800,000
Retained earnings	20	52,683	116,790
Other equity/(losses)	20	57	(4,894)
Share option reserve	20	12,594	12,434
Total equity		865,334	924,330

The notes on pages 14 to 39 form an integral part of these financial statements.

Spirit Energy Production UK Limited

Balance Sheet as at 31 December 2018 (continued)

The financial statements on pages 9 to 39 were approved and authorised for issue by the Board of Directors on 19 September 2019 and signed on its behalf by:

....

NJ McCulloch
Director

Company number 03115179

Statement of Changes in Equity for the Year Ended 31 December 2018

	Share capital £ 000	Cash flow hedge reserve £ 000	Share option reserve £ 000	Retained earnings £ 000	Total equity £ 000
At 1 January 2018	800,000	(4,894)	12,434	116,790	924,330
Loss for the year	-	-	-	(59,213)	(59,213)
Other comprehensive income	-	57	-	-	57
Total comprehensive income/(loss)	-	57	-	(59,213)	(59,156)
Transfer of reserves	-	4,894	-	(4,894)	-
Equity-settled share-based payment transactions	-	-	160	-	160
	-	4,894	160	(4,894)	160
At 31 December 2018	800,000	57	12,594	52,683	865,334

	Share capital £ 000	Share premium £ 000	Actuarial gains and losses reserve £ 000	Cash flow hedge reserve £ 000	Share option reserve £ 000	Retained earnings £ 000	Total equity £ 000
At 1 January 2017	800,000	447,162	(50,515)	-	5,886	583,796	1,786,329
Loss for the year	-	-	-	-	-	(42,891)	(42,891)
Other comprehensive income/(loss)	-	-	12,238	(4,894)	-	-	7,344
Total comprehensive income/(loss)	-	-	12,238	(4,894)	-	(42,891)	(35,547)
Dividends	-	-	-	-	-	(833,000)	(833,000)
Share capital reduction	-	(447,162)	-	-	-	447,162	-
Equity-settled share-based payment transactions	-	-	-	-	6,548	-	6,548
Transfer of cumulative actuarial losses due to settlement of scheme	-	-	38,277	-	-	(38,277)	-
	-	(447,162)	38,277	-	6,548	(424,115)	(826,452)
At 31 December 2017	800,000	-	-	(4,894)	12,434	116,790	924,330

The notes on pages 14 to 39 form an integral part of these financial statements.

Spirit Energy Production UK Limited

Notes to the Financial Statements for the Year Ended 31 December 2018

1. General information

Spirit Energy Production UK Limited ('the Company') is a private company limited by shares, incorporated and domiciled in the United Kingdom and registered in England and Wales.

The principal place of business is:

1st Floor
20 Kingston Road
Staines-upon-Thames
England
TW18 4LG

The nature of the Company's operations and its principal activities are set out in the Strategic Report on pages 1 to 2.

2. Accounting policies

Basis of preparation

The Company meets the definition of a qualifying entity under Financial Reporting Standard 100 issued by the Financial Reporting Council. The financial statements therefore have been prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework ('FRS 101'). In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU ('Adopted IFRSs') but makes amendments where necessary in order to comply with Companies Act 2006 and has set out below where advantage of the FRS 101 disclosure exemptions has been taken.

From 1 January 2018, the following amendments are effective in the Company's financial statements. Their first-time adoption did not have a material impact on the financial statements:

- IFRS 9 'Financial Instruments'; and
- IFRS 15 'Revenue from contracts with customers'.

As the consolidated financial statements of Spirit Energy Limited (the 'Group'), which are available from its registered office, include the equivalent disclosures, the Company has taken the exemptions under FRS 101 available in respect of the following disclosures:

- the requirements of IFRS 7 'Financial Instruments: Disclosures';
- the requirements of IAS 7 'Statement of Cash Flows;
- the statement of compliance with Adopted IFRSs;
- the effects of new but not yet effective IFRSs;
- prior year reconciliations for property, plant and equipment;
- the prior year reconciliations in the number of shares outstanding at the beginning and at the end of the year for share capital;
- disclosures in respect of related-party transactions with wholly-owned subsidiaries in a group;
- disclosures in respect of the compensation of key management personnel; and
- disclosures in respect of capital management.

2. Accounting policies (continued)

Summary of significant accounting policies and key accounting estimates
The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Revenue recognition
Revenue comprises the fair value of the consideration received or receivable for the sale of goods and provision of services in the ordinary course of the Company's activities and is recognised to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be measured reliably. Revenue associated with exploration and production sales (of natural gas, crude oil and condensates) is recognised when the customer obtains control of the goods. Revenue from the production of natural gas, oil and condensates in which the Company has an interest with other producers is recognised based on the Company's working interest and the terms of the relevant production sharing arrangements (the entitlement method).

Where differences arise between production sold and the Company's share of production, this is accounted for as an overlift or underlift (see separate accounting policy). Purchases and sales entered into to optimise the performance of production facilities are presented net within revenue.

Revenue is shown net of sales/value added tax, returns, rebates and discounts.

Cost of sales
Cost of sales relating to gas and oil production includes depreciation of assets used in production of gas and oil and direct labour costs.

Overlift and underlift
Off-take arrangements for oil and gas produced from joint operations are often such that it is not practical for each participant to receive or sell its precise share of the overall production during the period. This results in short-term imbalances between cumulative production entitlement and cumulative sales, referred to as overlift and underlift.

An overlift payable, or underlift receivable, is recognised at the balance sheet date within trade and other payables, or trade and other receivables, respectively, and measured at market value, with movements in the period recognised within cost of sales.

Measurement convention
The financial statements have been prepared on the historical cost basis except for derivative financial instruments that have been measured at fair value.

These financial statements are presented in pound sterling (with all values rounded to the nearest thousand pounds (£000) except when otherwise indicated), which is also the functional currency of the Company.

Going concern
The financial statements have been prepared using the going concern basis of accounting as Spirit Energy Limited, an intermediate parent company, has agreed to provide financial support until 21 October 2020.

Finance income
Finance income is recognised in the Income Statement in the period in which the income is earned.

Finance costs
Finance costs are recognised in the Income Statement in the period in which they are incurred.

2. Accounting policies (continued)

Employee share schemes
The Centrica plc group, to which the Company belongs, has a number of employee share schemes, detailed in the Remuneration Report, on pages 90 to 91 and in note S2 to the Centrica plc Annual Report and Accounts 2018, under which it makes equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant (excluding the effect of non market-based vesting conditions). The fair value determined at the grant date is expensed on a straight-line basis in the Income Statement together with a corresponding increase in equity over the vesting period, based on Centrica plc group's estimate of the number of awards that will vest, and adjusted for the effect of non-market-based vesting conditions.

Fair value is measured using methods appropriate to each of the different schemes detailed in note S2 of the Centrica plc financial statements.

Decommissioning costs
Provision is made for the net present value of the estimated cost of decommissioning gas and oil production facilities at the end of the producing lives of fields based on price levels and technology at the balance sheet date.

When this provision relates to an asset with sufficient future economic benefits, a decommissioning asset is recognised and included as part of the associated property, plant and equipment ('PP&E') and depreciated accordingly. If there is an indication that the new carrying amount of the asset is not fully recoverable, the asset is tested for impairment and an impairment loss is recognised where necessary. Changes in these estimates and changes to the discount rates are dealt with prospectively and reflected as an adjustment to the provision and corresponding decommissioning asset included within PP&E. The unwinding of the discount on the provision is included in the income statement within interest expense.

Leases
The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and whether the arrangement conveys a right to use the asset or assets. Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are capitalised and included in property, plant and equipment at their fair value, or if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The obligations relating to finance leases, net of finance charges in respect of future periods, are included within borrowings, with the amount payable within 12 months included in borrowings within current liabilities.

Lease payments are apportioned between finance charges and reduction of the finance lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Payments under operating leases are charged to the Income Statement on a straight-line basis over the term of the relevant lease.

2. Accounting policies (continued)

Borrowing costs
Borrowing costs that arise in connection with the acquisition, construction or production of a qualifying asset are capitalised and subsequently amortised in line with the depreciation of the related asset. Borrowing costs are capitalised from the time of acquisition or from the beginning of construction or production until the point at which the qualifying asset is ready for use. Where a specific financing arrangement is in place, the specific borrowing rate for that arrangement is applied. For non-specific financing arrangements, a financing rate representative of the weighted average borrowing rate is used. Borrowing costs not arising in connection with the acquisition, construction or production of a qualifying asset are expensed.

Foreign currencies
Transactions in foreign currencies are initially recorded at the functional currency rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into the functional currency of the Company at the rates prevailing at the balance sheet date, and associated gains and losses are recognised in the Income Statement for the year, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges. Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the Income Statement within 'finance income' or 'finance costs'. All other foreign exchange gains and losses are presented in the Income Statement in the respective financial line item to which they relate.

Non-monetary items that are measured at historical cost in a currency other than the functional currency of the Company are translated using the exchange rate prevailing at the dates of the initial transaction and are not retranslated. Non-monetary items measured at fair value in foreign currencies are retranslated at the rates prevailing at the date when the fair value was measured.

Taxation
Current tax, including UK corporation tax, UK petroleum revenue tax and foreign 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 temporary differences identified at the reporting date, except to the extent that the deferred tax arises from the initial recognition of goodwill (if impairment of goodwill is not deductible for tax purposes) or the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction affects neither accounting profit nor taxable profit and loss. Temporary differences are differences between the carrying amount of the Company's assets and liabilities and their tax base.

Deferred tax liabilities may be offset against deferred tax assets within the same taxable entity or qualifying local tax group. Any remaining deferred tax asset is recognised only when, on the basis of all available evidence, it can be regarded as probable that there will be suitable taxable profits, within the same tax jurisdiction, in the foreseeable future, against which the deductible temporary differences can be utilised.

Deferred tax is provided on temporary differences except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the asset is realised or liability settled, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Measurement of deferred tax liabilities and assets reflects the tax consequences expected from the manner in which the asset or liability is recovered or settled.

2. Accounting policies (continued)

Development and production assets

All field development costs are capitalised as PP&E. Such costs relate to the acquisition and installation of production facilities and include development drilling costs, project-related engineering and other technical services costs. PP&E, including rights and concessions related to production activities, are depreciated from the commencement of production in the fields concerned, using the unit of production method ('UOP'), based on all the 2P reserves of those fields. Changes in these estimates are dealt with prospectively.

The net carrying value of fields in production and development is compared on a field-by-field basis with the likely discounted future net revenues to be derived from the remaining commercial reserves. An impairment loss is recognised where it is considered that recorded amounts are unlikely to be fully recovered from the net present value of future net revenues.

Property, plant and equipment ('PP&E')

PP&E is included in the Balance Sheet at cost, less accumulated depreciation and any provisions for impairment. The initial cost of an asset comprises its purchase price or construction cost and any costs directly attributable to bringing the asset into operation. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Subsequent expenditure in respect of items of PP&E such as the replacement of major parts, major inspections or overhauls, are capitalised as part of the cost of the related asset where it is probable that future economic benefits will arise as a result of the expenditure and the cost can be reliably measured. All other subsequent expenditure, including the costs of day-to-day servicing, repairs and maintenance, is expensed as incurred.

Freehold land is not depreciated. Other PP&E, with the exception of upstream production assets (for which the 'unit of production method' ('UOP') is used), are depreciated on a straight-line basis at rates sufficient to write off the cost, less estimated residual values, of individual assets over their estimated useful lives.

Depreciation

Depreciation is charged as follows:

Asset classes	**Depreciation method and rate**
Development and production assets	UOP, based on 2P reserves

Assets held under finance leases are depreciated over their expected useful lives on the same basis for owned assets, or where shorter, the lease term.

The carrying values of PP&E are tested annually for impairment and are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. Residual values and useful lives are reassessed annually, and if necessary changes are accounted for prospectively.

Inventories

Commodity inventories (oil and gas) are valued at market value. Other inventories are valued on a weighted-average cost basis, at the lower of cost or estimated net realisable value after allowance for redundant and slow-moving items.

The cost of inventories includes the purchase price plus costs of conversion incurred in bringing the inventories to their present location and condition.

Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, that can be measured reliably, and it is probable that the Company will be required to settle that obligation. Provisions are measured at the balance sheet date at best estimate of the expenditure required to settle the obligation, and are discounted to present value where the effect is material.

Where discounting is used, the increase in the provision due to the passage of time is recognised in the Income Statement within finance cost.

2. Accounting policies (continued)

Pensions and other post-employment benefits

The Company's employees participate in a number of the Centrica plc Group's defined benefit pension schemes. The total Group cost of providing benefits under defined benefit schemes is determined separately for each of the Group's schemes under the projected unit credit actuarial valuation method. Actuarial gains and losses are recognised in full in the period in which they occur. The key assumptions used for the actuarial valuation are based on the Group's best estimate of the variables that will determine the ultimate cost of providing post-employment benefits, on which further detail is provided in note 22 to the Group financial statements. The Company's share of the total Group surplus or deficit at the end of the reporting period for each scheme is calculated in proportion to the Company's share of ordinary employer contributions into that scheme during the year; ordinary employer contributions are determined by the pensionable pay of the Company's employees within the scheme and the cash contribution rates set by the scheme trustees. Current service cost is calculated with reference to the pensionable pay of the Company's employees. The Company's share of the total Group interest on scheme liabilities, expected return on scheme assets and actuarial gains or losses is calculated in proportion to ordinary employer contributions in the prior accounting period. Changes in the surplus or deficit arising as a result of the changes in the Company's share of total ordinary employer contributions are also treated as actuarial gains or losses.

Payments to defined contribution retirement benefit schemes are recognised in the Company's Income Statement as they fall due.

Exceptional items

Exceptional items are those items that, in the judgement of the Directors, need to be disclosed separately by virtue of their nature, size or incidence. To ensure the business performance reflects the underlying results of the Company, these exceptional items are disclosed separately in the Income Statement. Items which may be considered exceptional in nature include disposals of businesses, business restructurings, significant onerous contract charges and asset write-downs/impairments.

Impairment

The carrying amounts of the Company's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date, or earlier when events or changes in circumstances indicate an impairment, to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit ('CGU') is the greater of its value in use and its fair value less costs of disposal. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the CGU).

An impairment loss is recognised if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss. Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

Financial assets, other than those at fair value through profit or loss, are assessed for indicators of impairment at each balance sheet date. In accordance with IFRS 9: *'Financial instruments'*, the Group has applied the ECL model to the financial assets at the balance sheet date as opposed to only incurred credit losses, and therefore it is not necessary for a credit event to have occurred before credit losses are recognised. Either the lifetime expected credit loss or a twelve-month expected credit loss is provided for, depending on the Company's assessment of whether the credit risk associated with the specific asset has increased significantly since initial recognition.

2. Accounting policies (continued)

Financial instruments

Financial assets and financial liabilities are recognised in the Company's Balance Sheet when the Company becomes a party to the contractual provisions of the instrument. Financial assets are de-recognised when the Company no longer has the rights to cash flows, the risks and rewards of ownership or control of the asset. Financial liabilities are de-recognised when the obligation under the liability is discharged, cancelled or expires.

a) Trade and other receivables

Trade receivables are amounts due from customers for hydrocarbons sold in the ordinary course of business.

Trade receivables and related-party receivables are initially recognised at fair value, which is usually the original invoice amount and are subsequently held at amortised cost using the effective interest method (although, in practice, the discounting is often immaterial) less an impairment provision calculated under the expected credit loss model. Balances are written off when recoverability is assessed as being remote. If collection is due in one year or less, receivables are classified as current assets. If no,t they are presented as non-current assets.

b) Trade and other payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers.

Trade payables and related-party payables are initially recognised at fair value, which is usually the original invoice amount and are subsequently held at amortised cost using the effective interest method (although, in practice, the discounting is often immaterial). If payment is due within one year or less, payables are classified as current liabilities. If not, they are presented as non-current liabilities.

c) Share capital

Ordinary shares are classified as equity. Equity instruments are measured at the fair value of the cash or other resources received or receivable. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction from the proceeds received. Own equity instruments that are re-acquired (treasury or own shares) are deducted from equity. No gain or loss is recognised in the Company's Income Statement on the purchase, sale, issue or cancellation of the Company's own equity instruments.

d) Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and current balances with banks and similar institutions. Cash equivalents include cash on deposit with related parties, which are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value and have an original maturity of three months or less.

e) Loans and other borrowings

All interest-bearing and interest-free loans and other borrowings are initially recognised at fair value net of directly attributable transaction costs. After initial recognition, these financial instruments are measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, discount or premium, when applicable.

2. Accounting policies (continued)

Financial instruments (continued)

f) Derivative financial instruments

The Company routinely enters into sale and purchase transactions for physical delivery of gas and oil. A portion of these transactions take the form of contracts that were entered into and continue to be held for the purpose of receipt or delivery of the physical commodity in accordance with the Company's expected sale, purchase or usage requirements ('own use' contract), and are not within the scope of IAS 39.

Certain purchase and sales contracts for the physical delivery of gas and oil are within the scope of IAS 39 due to the fact that they net settle or contain written options. Such contracts are accounted for as derivatives under IAS 39 and are recognised in the Company's Balance Sheet at fair value. Gains and losses arising from changes in fair value on derivatives that do not qualify for hedge accounting are taken directly to the Income Statement for the year.

The Company uses a range of derivatives for both trading and to hedge exposures to financial risks, such as interest rate, foreign exchange and energy price risks, arising in the normal course of business. The use of derivative financial instruments is governed by the Group's policies. Further detail on the Group's risk management policies is included within the Group's consolidated financial statements for the year ended 31 December 2018, in the Strategic Report on page 5 and in note S2.

The accounting treatment for derivatives is dependent on whether they are entered into for trading or hedging purposes. A derivative instrument is considered to be used for hedging purposes when it alters the risk profile of an underlying exposure of the Company in line with the Company's risk management policies and is in accordance with established guidelines, which require the hedging relationship to be documented at its inception, ensure that the derivative is highly effective in achieving its objective, and require that its effectiveness can be reliably measured. The Company also holds derivatives which are not designated as hedges and are held for trading.

All derivatives are recognised at fair value on the date on which the derivative is entered into and are re-measured to fair value at each balance sheet date. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Derivative assets and derivative liabilities are offset and presented on a net basis only when both a legal right of set-off exists and the intention to net settle the derivative contracts is present.

The Company enters into certain energy derivative contracts covering periods for which observable market data does not exist. The fair value of such derivatives is estimated by reference in part to published price quotations from active markets, to the extent that such observable market data exists, and in part by using valuation techniques, whose inputs include data which is not based on or derived from observable markets. Where the fair value at initial recognition for such contracts differs from the transaction price, a fair value gain or fair value loss will arise. This is referred to as a day-one gain or day-one loss. Such gains and losses are deferred (not recognised) and amortised to the Income Statement based on volumes purchased or delivered over the contractual period until such time observable market data becomes available. When observable market data becomes available, any remaining deferred day-one gains or losses are recognised within the Income Statement. Recognition of the gains or losses resulting from changes in fair value depends on the purpose for issuing or holding the derivative. For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the Income Statement and are included within gross profit or interest income and interest expense. Gains and losses arising on derivatives entered into for speculative energy trading purposes are presented on a net basis within revenue.

3. Critical accounting judgements and key sources of estimation uncertainty

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

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

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of revision and future periods if the revision affects both current and future periods.

a) Critical judgements in applying the Company's accounting policies

Such key judgements include the presentation of selected items as exceptional (see note 8). No other key judgements have been made by the Directors in applying the Company's accounting policies.

b) Key sources of estimation uncertainty

The key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Decommissioning costs

The estimated cost of decommissioning at the end of the producing lives of fields (including storage facility assets) is reviewed annually and is based on reserves, price levels and technology at the balance sheet date. Provision is made for the estimated cost of decommissioning at the balance sheet date. The payment dates of total expected future decommissioning costs are uncertain and dependent on the lives of the facilities, but are currently anticipated to be incurred until 2038, with the majority of the costs expected to be paid between 2025 and 2030.

Gas and liquids reserves

The volume of 2P gas and liquids reserves is an estimate that affects the UOP depreciation of producing gas and liquids PP&E as well as being a significant estimate that affects decommissioning and impairment calculations. The factors impacting gas and liquids estimates, the process for estimating reserve quantities and reserve recognition are described in the Group's consolidated financial statements for the year ended 31 December 2018 on page 60.

The impact of a change in estimated 2P reserves is dealt with prospectively by depreciating the remaining book value of producing assets over the expected future production. If 2P reserves estimates are revised downwards, earnings could be affected by higher depreciation expense or an immediate write-down (impairment) of the asset's book value.

Determination of fair values - energy derivatives

Fair values of energy derivatives are estimated by reference in part to published price quotations in active markets and in part by using valuation techniques. Quoted market prices considered for valuation purposes are the bid price for assets held and/or liabilities to be issued, or the offer price for assets to be acquired and/or liabilities held, although the mid-market price or another pricing convention may be used as a practical expedient (where typically used by other market participants). The judgements and the assumptions underpinning these judgements are considered to be appropriate.

Impairment of long lived assets

The Company has several material long-lived assets that are assessed for impairment at each reporting date or earlier if events or changes in circumstances indicate an impairment might exist. The Company makes judgements and estimates in considering whether the carrying amounts of these assets or CGUs are recoverable. The key assets that are subjected to impairment tests are E&P gas and oil assets the carrying value of which is £357,432,000 (2017: £343,491,000) as at 31 December 2018 (See note 13).

Upstream gas and oil assets

The recoverable amount of the Company's gas and oil assets is determined by discounting the post-tax cash flows expected to be generated by the assets over their lives taking into account those assumptions that market participants would take into account when assessing fair value. The cash flows are derived from projected production profiles of each field, based predominantly on expected 2P reserves and take into account forward prices for gas and liquids over the relevant period. Where forward market prices are not available, prices are determined based on internal model inputs which requires professional judgement and assumptions to be used.

4. Revenue

The analysis of the Company's revenue for the year from continuing operations is as follows:

	2018 £ 000	2017 £ 000
Sale of gas and liquids from production	84,903	55,957

All revenue was generated in the United Kingdom.

5. Remeasurement of derivatives

	2018 £ 000	2017 £ 000
(Loss)/gain on the remeasurement of energy derivatives	(12,243)	606

Spirit Energy Production UK Limited

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

6. Analysis of costs by nature

	2018			2017		
Year ended 31 December	**Cost of sales**	**Operating costs**	**Total costs**	**Cost of sales**	**Operating costs**	**Total costs**
	£ 000	**£ 000**	**£ 000**	**£ 000**	**£ 000**	**£ 000**
Inventories written down	-	6,145	6,145	-	5,334	5,334
Depreciation, impairment and write-downs/(write-backs) (note 13)	28,904	(10)	28,894	19,064	-	19,064
Employee costs (note 7)	28,939	21,309	50,248	19,439	11,264	30,703
Foreign exchange losses/(gains)	-	157	157	-	(67)	(67)
Other operating costs	107,255	13,762	121,017	132,149	9,222	141,371
Total operating costs by nature	165,098	41,363	206,461	170,652	25,753	196,405

7. Employers' costs

The aggregate employee costs (including Directors' remuneration) were as follows:

	2018 £ 000	2017 £ 000
Wages and salaries	40,203	15,572
Social security costs	5,505	3,480
Pension and other post-employment benefits	4,024	3,391
Share-based payment expenses	516	8,260
	50,248	30,703

In respect of the Directors' remuneration, refer to note 9 'Directors' remuneration'.

The monthly average number of persons employed by the Company (including Directors) during the year, analysed by category was as follows:

	2018 No. of employees	2017 No. of employees
Gas and oil production	212	216
Administration, finance and other support functions	282	47
	494	263

Centrica plc's exploration and production employees and certain group functions were moved into Spirit Energy Production UK Limited as part of the formation of the Spirit Energy Group in December 2017.

8. Exceptional items

The following exceptional items were recognised in arriving at operating profit of the reporting period:

	2018 £ 000	2017 £ 000
Restructuring costs	-	(924)
Impairment charges (note 13)	-	(270,815)
	-	(271,739)

During the prior year, the Company recognised:

- costs of £924,000 in relation to restructuring of the business;
- impairment charges on tangible assets of £117,269,000 on the South Morecambe field and £153,546,000 on the Rhyl field.

9. Directors' remuneration

The Directors' remuneration for the year was as follows:

	2018 £ 000	2017 £ 000
Directors' emoluments	622	652
Contributions into pension schemes	26	52
Compensation for loss of office	-	4
	648	708

Remuneration of the highest paid Director:

	2018 £ 000	2017 £ 000
Director emoluments	225	204
Contributions into pension schemes	-	14
	225	218

During the year, the highest paid Director did not exercise share options and did not receive shares under a long-term incentive scheme.

10. Net finance (cost)/income

Finance income

	2018 £ 000	2017 £ 000
Interest income from amounts owed by Group undertakings	4,442	43,802
Net foreign exchange gain on financing transactions	250	-
Total finance income	4,692	43,802

Finance cost

	2018 £ 000	2017 £ 000
Interest on amounts owed to Group undertakings	(1,949)	(36,730)
Interest on bank overdrafts and borrowings	-	(472)
Net foreign exchange losses on financing transactions	-	(112)
Unwind of discount on provisions (note 17)	(7,203)	(5,253)
Net cost of post-employment benefits	-	(433)
Total finance cost	(9,152)	(43,000)
Net finance (cost)/income	(4,460)	802

11. Auditor's remuneration

The Company paid the following amounts to its auditor in respect of the audit of the Company's financial statements.

	2018 £ 000	2017 £ 000
Audit fees	25	25

12. Tax

	2018 £ 000	2017 £ 000
Current tax		
UK corporation tax at 40% (2017: 40%)*	(29,825)	(20,117)
UK petroleum revenue tax	(62,350)	(55,299)
UK Corporation tax adjustments in respect of prior years	(5,886)	(23,631)
Total current tax	(98,061)	(99,047)
Deferred tax		
Origination and reversal of timing differences - UK	(21,506)	(71,637)
UK petroleum revenue tax	30,825	(202,847)
Arising from previously unrecognised tax loss, tax credit or temporary difference of prior years	9,694	5,643
Total deferred tax	19,013	(268,841)
Tax on loss	(79,048)	(367,888)

*The tax rates of the comparative figure have been combined to reflect the rate applicable to the Company.

The main rate of corporation tax for the year to 31 December 2018 was 19% (2017: 19.25%). The corporation tax rate will reduce to 17% with effect from 1 April 2020 following the enactment of Finance Act 2016. The deferred tax assets and liabilities included in these financial statements are based on the reduced rate of 17% having regard to their reversal profiles.

Upstream gas and oil production activities are taxed at a corporation tax rate of 30% (2017: 30%) plus a supplementary charge of 10% (2017: 10%) to give an overall rate of 40% (2017: 40%). In addition, certain upstream assets in the UK attract petroleum revenue tax ('PRT') at 0% (2017: 0%), giving an overall effective rate of 40% (2017: 40%). Upstream deferred tax assets and liabilities included in these financial statements are based on the 40% overall effective tax rate having regard for their reversal profiles.

The differences between the taxes shown above and the amounts calculated by applying the standard rate of UK corporation tax to the loss before tax are reconciled below:

	2018 £ 000	2017 £ 000
Loss before tax	(138,261)	(410,779)
Tax on loss at standard UK corporation tax rate of 40% (2017: 40%)*	(55,304)	(164,311)
Effects of:		
Changes to tax rates	-	(25,963)
Net expenses non-deductible for tax purposes	(4)	165
UK petroleum revenue tax rates	(62,350)	(55,299)
Adjustments in respect of prior years	3,808	(17,988)
(Decrease)/increase from effect of different UK tax rates on some earnings	(804)	9,909
Impact of petroleum revenue tax	12,613	103,257
Additional relief on abandonment expenditure	(4,004)	(11,042)
Ring fenced expenditure supplement	(3,850)	(3,687)
Share scheme deduction	22	(82)
Deferred petroleum revenue tax	30,825	(202,847)
Total tax	(79,048)	(367,888)

12. Tax(continued)

The movements in respect of the deferred income tax assets and liabilities that occurred during the financial year are as follows:

	Accelerated tax depreciation (corporation tax)	Other timing differences including losses carried forward	Retirement benefit obligation and other provisions	Total
	£ 000	£ 000	£ 000	£ 000
1 January 2017	(131,610)	16,721	136,388	21,499
Credited to the Income Statement	97,127	151,855	19,859	268,841
Charged to other comprehensive income	-	-	(4,894)	(4,894)
31 December 2017	(34,483)	168,576	151,353	285,446
(Charged)/credited to the Income Statement	(104,344)	(11,959)	97,290	(19,013)
Charged to other comprehensive income	-	-	-	-
31 December 2018	(138,827)	156,617	248,643	266,433

13. Property, plant and equipment

	Development & production assets £ 000
Cost	
At 1 January 2018	3,757,102
Additions	35,236
Revision to decommissioning assets (note 17)	7,599
At 31 December 2018	3,799,937
Accumulated depreciation and impairment	
At 1 January 2018	(3,413,611)
Depreciation charge for the year	(28,894)
At 31 December 2018	(3,442,505)
Carrying amount	
At 31 December 2018	357,432
At 31 December 2017	343,491

Impairment

During the prior year, the Company recognised impairment charges of £117,269,000 on the South Morecambe field and £153,546,000 on the Rhyl field, reducing the carrying value of the assets to their recoverable amounts driven by a reduction in 2P reserves and increases in future operating and abandonment costs.

The recoverable amounts of the assets are categorised in Level 3 (as explained in note 25) of the fair value hierarchy and have been calculated on a fair value less costs of disposal basis.

The future post-tax cash flows are discounted using a post-tax nominal discount rate of 9.5% (2017: 8.5%) to determine fair value less costs of disposal.

There were no other impairment indicators identified as at 31 December 2018 or 31 December 2017 in relation to the remaining PP&E. Similarly, there were no 'triggering events' in either year justifying a reversal of impairment losses previously recognised.

Assets held under finance leases

The net carrying amount of PP&E includes the following amounts in respect of assets held under finance leases:

	2018 £ 000	2017 £ 000
Cost-capitalised finance lease	414,632	414,632
Accumulated depreciation	(413,703)	(399,096)
Net book value	929	15,536

14. Trade and other receivables

	2018 Current £ 000	2017 Current £ 000
Trade receivables	2,302	3,316
Amounts owed by fellow Group undertakings	743,118	816,558
Amounts owed from other related parties (note 24)	11,047	-
Accrued income	3,288	2,144
Other receivables	4,790	1,941
	764,545	823,959

The amounts owed by Group undertakings have been presented on a net basis as there is a right of offset against certain amounts. Included within the net amounts owed by Group undertakings disclosed above is £680,510,000 (2017: £778,654,000) that bears interest at a quarterly rate of 0.50% (2017: 0.50%). The other net amounts owed by Group undertakings are interest-free. All amounts owed by Group undertakings are unsecured and repayable on demand.

The expected credit loss (ECL) on amounts due to fellow Spirit Energy Group undertakings has been calculated on the basis of a twelve-month ECL as there has been no significant increase in credit risk since the inception of the loans. The level of the ECL is considered to be immaterial as the undertakings have the financial support of Spirit Energy Limited, the immediate parent company.

15. Inventories

	2018 £ 000	2017 £ 000
Operational spares and consumables	11,941	12,248

Operational spares and consumables recognised as an expense in the year and included in cost of sales amounted to £5,767,000 (2017: £4,246,000). The write-down of inventories to net realisable value amounted to £5,550,000 (2017: £5,334,000 in relation to North Morecambe and Bains) in relation to South Morecambe. The reversal of write-downs amounted to £nil (2017: £nil). The write-down is included in operating costs.

There is no significant difference between the replacement cost of inventories and their carrying amounts.

16. Trade and other payables

	2018 Current £ 000	2017 Current £ 000
Trade payables	8,722	12,426
Accrued expenses	1,464	70
Amounts owed to Group fellow undertakings	9,311	1,837
Amounts owed to other related parties (note 24)	3,859	-
Social security and other taxes	23	23
Other payables	29,169	36,357
	52,548	50,713

The amounts owed to Group undertakings have been presented on a net basis as there is a right of offset against certain amounts.

The amounts owed to Group undertakings are interest-free, unsecured and repayable on demand.

17. Provision for other liabilities and charges

	Decommissioning £ 000
At 1 January 2018	559,957
Revision to provision on existing assets (note 13)	7,599
Provision used	(28,925)
Increase due to discount unwinding (note 10)	7,203
At 31 December 2018	545,834
Non-current liabilities	480,707
Current liabilities	65,127

Decommissioning

The Company has recognised provisions for its obligations to decommission its oil and gas fields at the end of their operating lives. The provisions recognised represent the best estimate at the balance sheet date of the expenditures required to settle the present obligation based on existing technology and current legislation requirements. Such cost estimates, expressed at current price levels at the date of the estimate, are discounted using a long-term pre-tax real rate of 1.2% (2017: 1.2%).

The timing of decommissioning payments are dependent on the lives of a number of fields but are anticipated to occur between 2019 and 2038 (2017: 2018 and 2038).

18. Borrowings

	2018 £ 000	2017 £ 000
Non-current borrowings		
Finance lease liabilities	118	148

	2018 £ 000	2017 £ 000
Current borrowings		
Finance lease liabilities	15	15

Finance lease liabilities

The Company entered into lease arrangements in respect of its South Morecambe gas field production assets. The lease term is 5 years.

Finance lease liabilities are secured as the rights to the leased asset revert to the lessor in the event of default.

The undiscounted minimum lease payments at the end of the reporting period are as follows:

	2018 £ 000	2017 £ 000
Not later than 1 year	15	15
Later than 1 year and not later than 5 years	150	180
	165	195
Less: future finance charge on finance lease liabilities	(32)	(32)
	133	163

The present value of the finance lease liabilities is as follows:

	2018 £ 000	2017 £ 000
Not later than 1 year	15	15
Later than 1 year and not later than 5 years	118	148
	133	163

19. Post-retirement benefits

(a) Summary of main schemes

Until 8 December 2017 the Company's employees participated in the following defined benefit pension schemes: Centrica Pension Plan (CPP) and Centrica Pension Scheme (CPS). Its employees also participated in the defined contribution section of the Centrica Pension Scheme. Information on these schemes is provided in note 22 of the Centrica plc 2018 Annual Report and Accounts.

Together with the Centrica Engineers Pension Scheme (CEPS), CPP and CPS form the majority of the Company's defined benefit obligation and are referred to below and in the Centrica plc 2018 Annual Report and Accounts as the 'Registered Pension Schemes'.

On 8 December 2017 Centrica plc combined its Exploration & Production business with that of Bayerngas Norge. As a result the Registered Pension Schemes closed for future accrual and employees within the Company became deferred members. The defined pension liability was assumed by Centrica plc under a flexible apportionment arrangement and the Company ceased to retain any ongoing obligation with regard to the Registered Pension Schemes.

(b) Accounting assumptions, risks and sensitivity analysis

The accounting assumptions, risks and sensitivity analysis for the Registered Pension Schemes are provided in note 22 to the Centrica plc 2018 Annual Report and Accounts.

(c) Reconciliation of scheme assets and liabilities

The amounts recognised in the Balance Sheet are as follows:

	2018			2017		
	Assets £ 000	Liabilities £ 000	Total £ 000	Assets £ 000	Liabilities £ 000	Total £ 000
1 January	-	-	-	255,385	(265,769)	(10,384)
Items included in the Profit and Loss Account:						
Current service cost	-	-	-	-	(1,659)	(1,659)
Interest expense/(income)	-	-	-	6,704	(7,137)	(433)
Other measurements:						
Re-measurement gains/(losses)	-	-	-	(253,976)	266,212	12,236
Employer contributions	-	-	-	1,506	-	1,506
Plan participants contributions	-	-	-	12	(12)	-
Benefits paid from schemes	-	-	-	(9,631)	9,631	-
Transfer from provisions for other liabilities and charges	-	-	-	-	(1,266)	(1,266)
31 December	-	-	-	-	-	-

19. Post-retirement benefits (continued)

(d) Analysis of the actuarial gains/(losses) recognised in reserves

	2018 £ 000	2017 £ 000
Year ended 31 December		
Actuarial loss (actual return less expected return on pensions assets)	-	(253,976)
Experience loss arising on the scheme liabilities	-	(1,383)
Changes in assumptions underlying the present value of the schemes' liabilities	-	267,595
Cumulative actuarial losses recognised in reserves at 1 January, before adjustment for taxation	-	(68,477)
Transfer of cumulative actuarial gains/losses to retained earnings due to settlement of scheme	-	56,241
	-	-

(e) Pension scheme contributions

As explained in note (a), the Company no longer has any defined benefit obligation.

(f) Pension scheme assets

The major categories of scheme assets are as follows:

	2018 Quoted £ 000	2018 Unquoted £ 000	2018 Total £ 000	2017 Quoted £ 000	2017 Unquoted £ 000	2017 Total £ 000
31 December						
Equities	-	-	-	2,089,000	303,000	2,392,000
Property	-	-	-	-	369,000	369,000
Asset-backed contribution assets	-	-	-	-	864,000	864,000
Cash pending investment	-	-	-	3,000	-	3,000
Liability matching assets	-	-	-	1,663,000	952,000	2,615,000
High yield debt	-	-	-	280,000	1,450,000	1,730,000
Corporate bonds	-	-	-	1,276,000	-	1,276,000
Group pension scheme assets (i)	-	-	-	5,311,000	3,938,000	9,249,000
Company share of the above (£ 000)	-	-	-	-	-	-

(i) Total pension scheme assets for the UK pension schemes.

19. Post-retirement benefits (continued)

(g) Defined contributions schemes

The total cost charged to the Income Statement of £4,024,000 (2017: £1,300,000) represents contributions payable to these schemes by the Company at rates specified in the rules of the scheme.

20. Capital and reserves

Share capital

Allotted, called up, authorised and fully paid shares

	2018		2017	
	No. 000	**£ 000**	**No. 000**	**£ 000**
Ordinary shares of £1 each	800,000	800,000	800,000	800,000

The shares have attached to them full voting, dividend and capital distribution (including on winding up) rights. They do not confer any rights of redemption.

Reserves

Share premium

Consideration received for shares issued above their nominal value net of transaction costs. On 29 September 2017, a special resolution was passed to cancel and extinguish the full amount of share premium account.

Actuarial gains and losses reserve

The cumulative actuarial gains and losses on the defined benefit pension scheme. This is shown within other equity in the balance sheet. The pension scheme is now closed and the actuarial reserve has been transferred to retained earnings.

Share option reserve

Share option reserve reflects the obligation to deliver shares to employees under the existing share schemes in return for services provided to the Company. This is shown within other equity in the Balance Sheet.

Retained earnings

The balance classified as retained earnings includes the profits and losses realised by the Company in previous periods that were not distributed to the shareholders of the Company at the reporting date.

Cash flow hedge reserve

The cash flow hedging reserve comprises fair value movements on instruments designated as cash flow hedges under the requirements of IAS 39. Amounts are transferred from the cash flow hedging reserve to the Income Statement or the Balance Sheet as and when the hedged item affects the Income Statement or the Balance Sheet which is, for the most part, on receipt or payment of amounts denominated in foreign currencies and settlement of interest on debt instruments. This is included within other equity on the Balance Sheet.

Other equity

Other equity includes the cash flow hedge reserve on the balance sheet.

21. Share-based payments

Employee share schemes are designed to encourage participants to align their objectives with those of shareholders. The Company participates in seven share schemes which gave rise to a charge of £571,000 (2017: £8,260,000) which is shown under the financial line item 'operating costs'. The major schemes, which are all operated by Centrica plc, the ultimate parent company, are described below.

21. Share based payments (continued)

Sharesave (continued)

expire six months after maturity. (Exercise of options is subject to continued employment within the Group (except where permitted by the rules of the scheme).

The fair value of employee share options is measured using the Black-Scholes model.

On Track Incentive Plan

Awards under the OTIP were available to senior executives, senior and middle management. Awards vest subject to continued employment within the Centrica plc group in two stages: half after two years, the other half after three years. Leaving prior to the vesting date will normally mean forfeiting rights to invested share awards. Further information on the operation of the OTIP, and the related performance conditions can be found on pages 177 to 178 of the Centrica plc 2018 Annual Report and Accounts.

The fair value of services received in return for share awards granted are measured by reference to the fair value of share awards granted. For the scheme described above, the fair value of employee share awards is the market value of the award at the award date.

22. Operating leases

Leases as lessee

At 31 December 2018, the Company had total future minimum lease payments under non-cancellable operating leases in relation to the Morecambe Bay assets with the following maturities:

	2018 £ 000	2017 £ 000
Within one year	3,451	3,980
In two to five years	3,381	1,233
In over five years	1,038	777
	7,870	5,990

23. Other commitments and contingencies

The Company and Centrica plc, the ultimate parent company have agreed to provide security to a subsidiary undertaking of Royal Dutch Shell plc, BG International Limited, following the change of name of BG Exploration and Production Limited who, as original licence holder for the Morecambe gas fields, will have exposure to abandonment costs relating to the Morecambe gas fields should liabilities not be fully discharged by the Company and its ultimate parent company. The security is to be provided when the estimated future net revenue stream from the associated gas field falls below a predetermined proportion of the estimated decommissioning cost. The nature of the security may take a number of different forms and will remain in force until the costs of such decommissioning have been irrevocably discharged and the relevant legal decommissioning notices in respect of the relevant fields have been revoked. At 31 December 2018, the security provided was £200,657,000.

24. Related-party transactions

During the year, the Company entered into the following arm's length transactions with related parties (who are not members of the Spirit Energy Group but which were related parties since they are fellow subsidiaries of the wider Centrica plc group), and had the following associated balances:

2018	Sale of goods and services (i)	Purchase of goods and services (i)	Other - net interest	Other - cash flow hedge reserve (ii)	Amounts owed from	Amounts owed to
	£ 000	£ 000	£ 000	£ 000	£ 000	£ 000
Centrica plc	-	-	-	8	-	(240)
Centrica DG Limited	-	-	-	-	14	-
GB Gas Holdings Limited	-	(1,021)	177	-	-	(1,800)
British Gas Trading Limited	83,464	(1,467)	-	-	11,033	-
British Gas Services Limited	-	-	-	-	-	(8)
Centrica Management Services Limited	-	-	-	-	-	(631)
Centrica Energy Limited	-	(32,641)	-	-	-	(776)
Centrica Services Limited	-	-	-	-	-	(404)
	83,464	**(35,129)**	**177**	**8**	**11,047**	**(3,859)**

(i) Sale of goods and services includes recharges made to entities outside of the Group and purchase of goods and services includes recharges made by entities outside of the Group.
(ii) Representing gains/(losses) on derivatives that are hedge accounted.

2017	Sale of goods and services (i)	Purchase of goods and services (i)	Other - net interest	Other - cash flow hedge reserve (ii)	Amounts owed from	Amounts owed to
	£ 000	£ 000	£ 000	£ 000	£ 000	£ 000
Centrica plc	-	-	-	(104)	1,164	-
GB Gas Holdings Limited	-	-	(177)	-	2,186	-
British Gas Trading Limited	38,202	(106)	-	-	6,198	-
British Gas Services Limited	-	-	-	-	1,187	-
Centrica Energy Limited	-	-	-	606	606	-
Centrica Services Limited	-	-	-	-	-	(189)
	38,202	**(106)**	**(177)**	**502**	**11,341**	**(189)**

(i) Sale of goods and services includes recharges made to entities outside of the Group and purchase of goods and services includes recharges made by entities outside of the Group.
(ii) Representing gains/(losses) on derivatives that are hedge accounted.

25. Financial instruments at fair value

The Company buy and sells commodities through a mixture of contracts with operators of gas fields. These arrangements also include short-term forward market purchases of gas and electricity at fixed and floating prices. An analysis is performed to assess whether these arrangements are financial instruments or not ('own-use contracts').

The fair value information as disclosed below relates to supply contracts that are in scope of IFRS 9 'Financial Instruments', as well as to foreign currencies and interest rate derivatives entered into, to hedge the risks arising from the business of the Company. These trades are usually placed with Group counterparties that trade with third parties on it behalf ('back to back type arrangements').

Determination of fair values

The Company's policy for the classification and valuation of financial instruments is disclosed in the accounting policies section of these financial statements. The fair value hierarchy levels are determined in accordance with IFRS 13 'Fair value measurement' and are consistent with those used by Centrica plc, the Company's ultimate parent company.

Fair value hierarchy

Financial assets and financial liabilities measured and held at fair value are classified into one of three categories, known as hierarchy levels, which are defined according to the inputs used to measure fair value as follows:

- Level 1: Fair value is determined using observable inputs that reflect unadjusted quoted market prices for identical assets and liabilities.
- Level 2: Fair value is determined using significant inputs that may be directly observable inputs or unobservable inputs that are corroborated by market data.
- Level 3: Fair value is determined using significant unobservable inputs that are not corroborated by market data and may be used with internally developed methodologies that result in management's best estimate of fair value.

Financial instruments carried at fair value		Fair value hierarchy		
	Fair value and carrying value	**Level 1**	**Level 2**	**Level 3**
31 December 2018	**£ 000**	**£ 000**	**£ 000**	**£ 000**
Derivative financial assets – in hedge accounting relationships				
Energy derivatives	2,979	-	2,979	-
Foreign exchange derivatives	66	-	66	-
Total financial assets at fair value	3,045	-	3,045	-
Derivative financial liabilities – in hedge accounting relationships				
Energy derivatives	(14,615)	-	(14,615)	-
Total financial liabilities at fair value	(14,615)	-	(14,615)	-
Total financial instruments at fair value	(11,570)	-	(11,570)	-

25. Financial instruments at fair value (continued)

Financial instruments carried at fair value		Fair value hierarchy		
	Fair value and carrying value	**Level 1**	**Level 2**	**Level 3**
31 December 2017	**£ 000**	**£ 000**	**£ 000**	**£ 000**
Derivative financial assets – in hedge accounting relationships				
Energy derivatives	841	-	841	-
Foreign exchange derivatives	34	-	34	-
Total financial assets at fair value	875	-	875	-
Derivative financial liabilities – in hedge accounting relationships				
Energy derivatives	(235)	-	(235)	-
Foreign exchange derivatives	(15)	-	(15)	-
Total financial liabilities at fair value	(250)	-	(250)	-
Total financial instruments at fair value	625	-	625	-

26. Immediate and ultimate parent undertaking

The immediate parent undertaking of the Company is Spirit Energy Limited, a company registered in England and Wales.

Spirit Energy Limited is the parent undertaking of the smallest group of companies for which group financial statements are drawn up and of which the Company is a member. Spirit Energy Limited, which has its registered office at 1st Floor, 20 Kingston Road, Staines-upon-Thames, England, TW18 4LG, is registered in England and Wales. Copies of Spirit Energy Limited's financial statements can be obtained from the Register of Companies for England and Wales, Companies House, Crown Way, Cardiff, CF14 3UZ.

The Company's ultimate parent undertaking and controlling entity and the largest group of which the Company is a member and for which Group accounts are prepared is Centrica plc. Centrica plc has its registered office at Millstream, Maidenhead Road, Windsor, England, SL4 5GD and is registered in England and Wales. Centrica plc's financial statements can be obtained at www.centrica.com.