

Southern Gas Networks plc
Annual Report and Financial Statements
For the year ended 31 March 2017

Registered Number: 05167021

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Southern Gas Networks plc
Annual Report and Financial Statements
for the year ended 31 March 2017
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Southern Gas Networks plc

Company Information

Directors

Gregor Alexander (Chairman)
Robert McDonald
Guy Lambert
Andrew Jonathan Mark Taylor
Natalie Flageul
John McManus
Neil Fleming
Alejandro Lopez Delgado
Graham Juggins
Paul Jeffery

Alternate Director

Kenton Edward Bradbury

Company Secretary

Nicola Shand

Registered office

St Lawrence House
Station Approach
Horley
Surrey
RH6 9HJ

Registered auditor

Deloitte LLP
Statutory Auditor
London
United Kingdom

Registered number

05167021

Southern Gas Networks plc

Strategic report for the year ended 31 March 2017

This strategic report sets out the main trends and factors underlying the development and performance of the Company during the year ended 31 March 2017 as well as those matters which are likely to affect its future development and performance.

The business, its objectives and strategy

The Company operates the regulated gas transportation business for the South and South East of England gas distribution network, one of eight regional gas distribution networks in the United Kingdom. Its gas distribution network comprises approximately 49,000 kilometres of gas mains delivering natural gas to approximately 4.0 million domestic, commercial and industrial customers. The network stretches from Milton Keynes in the north, to Dover in the east and Lyme Regis in the west, including London boroughs to the south of the River Thames.

The Company is a wholly owned subsidiary of Scotia Gas Networks Limited ("**SGN**"). SGN is owned by a consortium made up of SSE plc, Borealis Infrastructure Europe (UK) Limited, which is indirectly wholly owned by OMERS Administration Corporation, OTPPB Investments (U.K.) Limited, which is owned by Ontario Teachers' Pension Plan Board and Blue Spyder B 2016 Limited, which is owned by Abu Dhabi Investment Authority. References to the "**Group**" throughout this Report mean SGN and its subsidiaries (including the Company).

The Company's business is regulated by the Office of Gas and Electricity Markets ("Ofgem").

Objectives and strategy

The Company's principal objectives are to deliver natural gas safely, reliably and efficiently across the gas distribution network and to provide the highest standard of service to our stakeholders, whilst delivering value to our shareholders. Its strategy therefore places the highest emphasis on ensuring activities are carried out safely and that the networks operate in a reliable and efficient manner, so that benchmarks and regulatory targets can be exceeded to the benefit of all of its stakeholders.

The Company's overall financial objective is to focus on operational efficiency and the efficient delivery of capital and replacement expenditure programmes. Therefore financial objectives are set to ensure the regulatory targets are achieved or outperformed.

The Company's financing objective is to ensure an efficient capital structure that mitigates interest rate risk through maintaining a minimum of 75% of debt at either fixed rates of interest or index linked.

External and regulatory environment

The management and operation of the Company's gas transportation assets are subject to a series of legislative requirements to ensure that assets are managed and operated in a safe and reliable manner. The Company must also ensure that arrangements are in place to respond to emergency situations and to ensure hazardous work is carried out safely and with minimum disruption.

The primary legislation controlling the Company's activities as a gas transporter is the Gas Act 1986 (as amended). Under the Gas Act, the Company holds a licence that allows it to operate the gas distribution network it owns. The Company is regulated by Ofgem, which has established price control mechanisms that govern the amount of revenue that can be earned by regulated businesses. Ofgem assesses the revenue and investment plans of the Company in order to determine an efficient level of expenditure and the quality of service requirements for the network are also taken into account. A cost of capital for the required investment in the networks is also determined.

The Company is also subject to safety legislation which is enforced by the Health and Safety Executive ("**HSE**") in the UK. The organisation processes and procedures are covered in a safety case which has been accepted by the HSE.

Southern Gas Networks plc

Strategic report for the year ended 31 March 2017 (continued)

Factors affecting the business

The Company's principal activity is the operation of a highly complex gas infrastructure network. As a consequence there are a number of factors that may influence the development and performance of the Company and the financial returns that can be achieved. The principal factors that influence the Company are as follows:

- **Regulatory price controls**

As outlined above, the prices that can be charged for the use of the Company's networks are determined in accordance with regulator approved price controls. The outcome of the eight-year review baselined the revenues that will be obtained over the price control period. In addition, targeted incentive schemes were introduced by the regulator whereby the Company is able to earn additional revenues by outperforming the targets, or alternatively penalised if the Company does not meet them.

Additionally, the regulatory price controls include an allowed rate of return for the investment the Company makes in the network. The level of the allowed rate of return determines the extent to which investment to increase the quality and capacity of the network is economically viable.

- **Safety and reliability of the networks**

The Company's ability to operate the networks safely and reliably is of the highest importance. Its performance in these areas affects the costs it incurs and the overall financial performance.

- **Efficiency**

The Company's objective is to ensure that gas is delivered as efficiently as possible through its network. This allows the Company to limit price increases and improve its own financial performance.

- **Interest rates**

The costs of financing our operations are affected by changes in interest rates as some of the Company's borrowings are held at floating rates. Exposure to changes in interest rates are hedged by holding both fixed rate and index linked borrowings and by holding derivative financial instruments (interest rate swaps) where necessary to achieve the desired profile of interest rate risk.

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Strategic report for the year ended 31 March 2017 (continued)

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 principal risks and uncertainties identified are as follows:

Description and Impact of Risk	Mitigation
Health and safety: Failures in the design or the implementation of our SHE management system may result in unsafe behaviour and working practices resulting in injuries or fatalities involving staff, contractors or members of the public; asset damage or loss; harm to the environment; and prosecution under relevant legislation.	Safety is the first of our core Company values. The Safety, Health and Environmental Advisory Committee of the Board and the Engineering Safety Committee are responsible for ensuring our safety, health and environmental policy is developed and adhered to. Compliance is supported by independent inspections and an audit programme.
Regulatory compliance: Failure to comply with regulatory requirements could result in prosecution; damage to our reputation; and financial penalties.	We have experienced regulation, finance and legal teams that manage and engage with all levels of Ofgem and Government. A system is in place to track prevailing energy related issues and to influence regulation and policy with the relevant authorities. Regulatory returns are now integrated in a workflow system which strengthens the review process at all levels.
Regulatory, legislative change and political risk: Regulatory, legislative or political reform could have an adverse impact on our business model. There is heightened uncertainty due to Brexit and potential Scottish independence.	We have policy and public affairs specialists who engage openly and constructively with legislators, officials and other policy makers on all aspects of energy and related environment policy. We have a proactive public affairs campaign with relevant stakeholders to highlight the long term value of the networks. At this stage, our reviews of the Brexit uncertainty do not indicate any material issues for our model and our assessment are on-going.
Asset management systems: Failures in the design or implementation of our asset management systems including health, physical security and integrity may result in a major incident leading to loss of life; adverse impact on the environment; loss of assets; prosecution under relevant legislation; and failure to meet our licence conditions.	We have a comprehensive asset management system, and are accredited by Lloyds Register with the internationally recognised ISO55000. There is a strong framework of engineering governance and risk management to ensure that all assets have a strategic plan through their lifecycle and are tracked through a number of committees reporting into the Engineering & Safety Committee. Also on an annual basis a number of audits and inspections are undertaken.

Southern Gas Networks plc

Strategic report

for the year ended 31 March 2017 (continued)

Security risk and IT service failure: Failures to implement appropriate security management of IT systems and physical assets could result in unauthorised access to our IT systems; unauthorised or fraudulent disclosure of sensitive information; vulnerability to external cyber attack; harm to engineering assets; and direct assault on premises resulting in harm to people and/or property.	We have a managed information security programme across all our activities to ensure resilient business operations. We conduct regular internal and external penetration and vulnerability tests of our network with government approved security partners to review our security posture. Plans are in place for recovery and resilience. Additionally we have adopted Centre for Protection of National Infrastructure good practice for physical security and are upgrading key sites. However, there is an increased priority due to recent cyber attacks on other organisations.
Finance risk: Failure to finance our obligations and new projects due to economic climate, lack of availability of finance and failure to set appropriate targets and sufficient management information could lead to inability to deliver expected financial returns.	The funding position, including gearing and future cash requirements, is continually reviewed and managed with regular updates to the Board. There is frequent dialogue with banks and credit rating agencies to assess the impacts of any economic changes, political changes such as Brexit or Scottish independence. Key performance metrics are reviewed by Executive and Board on a regular basis.
Maintaining a competent, productive and talented workforce: Failure to maintain a sufficiently competent, diverse and productive workforce with effective relationships and sufficient talent may result in resource/workload mismatches; failure to meet licence; regulatory or legislative requirements or take advantage of business opportunities.	We maintain workforce planning and a recruitment programme to ensure optimum resource management, ensuring critical skills and knowledge are retained in the business. This program is reviewed regularly at Executive and Board level. We also use external benchmarking of employment packages and keep abreast of general economic and industry developments to ensure we identify and respond to issues.
Operational execution: Failure to efficiently execute operational activities to the required standards could result in failure to meet licence; regulatory and legislative requirements; increased costs and financial losses; and damage to competitiveness and reputation.	We have designed an organisation structure and procedures to meet the relevant legislation and regulatory obligations. An independent inspection and audit regime is in place to ensure compliance to the required standards. Customised key performance reports are provided to Executive and Board on a regular basis.

The Board reviews the principal risks and uncertainties facing the business and considers the risk management processes in place, which are designed to safeguard assets and to manage, rather than eliminate, material risks to the achievement of business objectives. These reviews recognise that any such process can provide only reasonable, and not absolute, assurance against material misstatement or loss. Further details of the processes the Board has in place are also set out in the Corporate Governance Statement on pages 15 to 20.

Stakeholders

The Company has a range of external stakeholders including gas consumers, employees, suppliers and contractors, its regulator Ofgem and local governments and communities. The Company adopts an open and constructive approach, both in terms of the way it operates, the services it provides and the impact that its activities have on each of its stakeholders. The Company encourages and enables its employees to be active citizens in the communities in which they live and work, through schemes which support staff who are either raising money for, or giving their time to, UK charities, local community or youth sports groups. The Company matches eligible fund raising by individual members of staff.

Southern Gas Networks plc

Strategic report for the year ended 31 March 2017 (continued)

Key performance indicators

The Company measures the achievement of its objectives through the use of quantitative assessments and, where quantitative measures are less relevant, through the use of qualitative assessments. The principal key performance indicators ("KPIs") which are used to assess whether principal operating objectives have been achieved are set out below:

Key performance indicator	Description	Year ended 31 March 2017	Year ended 31 March 2016
Operating profit	Profit before financing costs and taxation	£349.7m	£363.4m
Capital expenditure	Additions to fixed assets	£80.4m	£77.0m
Replacement expenditure	Replacement expenditure is capitalised under FRS 102. It represents the cost of renewing sections of gas network with modern polyethylene pipes to improve future safety and reliability. The sections replaced include mains and smaller diameter service pipes, which connect customers and mains.	£177.3m	£158.3m
Debt to RAV ratio ¹	The Company's debt to RAV ratio	72.1%	72.2%
Employee lost time incidents	Incidents resulting in employees taking time off work (per 100,000 hours worked)	0.13⁴	0.06 ⁴
Customer satisfaction – planned interruptions	Results from customer satisfaction surveys (10 = very satisfied)	8.8²	8.8 ²
Customer satisfaction – unplanned interruptions	Results from customer satisfaction surveys (10 = very satisfied)	9.4³	9.4 ³
Escapes attendance	Proportion of uncontrolled escapes attended in one hour – percentage (target 97%)	98.4⁴	98.5 ⁴
Customer complaint volume reduction	This represents the year on year reduction in complaints expressed as a percentage. Complaint means any expression of dissatisfaction related to any areas of our operation.	10%⁴	39% ⁴

1 "RAV" is defined as Ofgem Regulatory Asset Value plus adjustments relating to the sharing of out/under performance against allowances. Debt for the purposes of the Debt to RAV ratio excludes liabilities arising from derivative financial instruments. The percentages stated are as at 31 March.

2 Based on customer satisfaction survey reports obtained for the nine month period ended 31 December 2016 and 2015 for the Group as a whole.

3 Based on customer satisfaction survey reports obtained for the nine month period ended 31 December 2016 and 2015 for the Group as a whole.

4 This KPI is measured for the Group, and accordingly the data presented is that for the Group as a whole.

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Strategic report for the year ended 31 March 2017 (continued)

Resources

The Company's principal resources are its assets and its people.

The Company's distribution network comprises approximately 49,000 kilometres of gas mains, together with associated services, plant and machinery and storage facilities.

The Company had 663 full time equivalent employees at 31 March 2017 (2016: 729). It places considerable value on the involvement of employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the Company during the year. It continues to invest in the development and training of its people in order to ensure both individual developmental needs and business skill requirements are met.

Financial review

The Company sets out below its financial review for the year ended 31 March 2017. The comparative figures presented are for the year ended 31 March 2016, as reported in the audited financial statements, unless otherwise stated.

Turnover for the year ended 31 March 2017 was £758.0m (2016: £736.9m) and has increased due to an additional site security allowance agreed as part of a price control re-opener. The majority of turnover was earned from charges made for the provision of gas transportation capacity as well as revenue based upon gas volumes transported in the year.

Profit for the year before taxation amounted to £243.7m (2016: £253.4m) and profit for the year after taxation amounted to £240.6m (2016: £268.4m).

Operating profit decreased to £349.7m (2016: £363.4m) with revenue increases being offset by significant lower gains on property sales compared with last year.

During the year the Company paid a dividend of £135m (2016: £nil).

Capital expenditure (excluding replacement expenditure) during the year amounted to £80.4m (2016: £77.0m). Capital expenditure is incurred to ensure that the networks continue to operate at minimum agreed pressures and that sufficient storage capacity is available to meet instances of peak demand, as well as when new connections or increased capacity are added to the networks.

Treasury policies and capital structure

The Company's operations are financed by a combination of equity and retained profits, bank borrowings and long term bonds. The Company's funding and liquidity are managed within a framework of policies and guidelines authorised by the Board of Directors. Further details are set out in the Directors' Report on pages 10 to 14.

As a matter of policy a minimum of 75% of debt is maintained at either fixed rates of interest or index linked. This policy is kept under review from time to time. Interest rate swaps are used, where necessary, in order to achieve this desired profile.

As at 31 March 2017, the Company's total senior debt (before issue costs) amounted to £2,624.6m (2016: £2,521.9m) and the debt to RAV ratio was 72.1% (2016: 72.2%). Of the total long term borrowings at 31 March 2017, after taking into account the effect of interest rate swaps, 81.9% were at either fixed rates of interest or were index linked (2016: 87.7%).

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Strategic report for the year ended 31 March 2017 (continued)

Pension commitments

A significant proportion of the Company's employees are members of the Scotia Gas Networks Pension Scheme which provides final salary defined benefits for members.

The Company accounts for any pension asset or liability in accordance with FRS 102. The net pension asset as at 31 March 2017 was £2.9m (2016: asset of £30.9m). Following the actuarial valuation carried out by the scheme's actuary as at 31 March 2015, annual special pension contributions remain at similar level for the Group at £22.2m (Company's share: £13.3m). These additional contributions will be paid annually until 31 March 2027 to repair the deficit in the defined benefit pension scheme. The Company's normal contributions remain at 37.3%.

Liquidity and cash flows

Liquidity is maintained through a mixture of long term borrowings and short term liquid funds in order that there are sufficient funds available for the Company's current and planned operations. Committed facilities are in place in order to provide funding for future capital and replacement expenditure as well as to provide sufficient available facilities to meet the seasonal working capital requirements of the Company. At 31 March 2017 the Company's committed undrawn revolving credit facility amounted to £250.0m (2016: £250.0m). The revolving credit facility is in place until July 2019.

Counterparty credit risk

The Company transacts with banks for the provision of interest rate and currency hedging transactions. The Company takes reasonable steps to maintain a minimum credit rating requirement as set out in its hedging policy; however, it recognises that at times the market conditions for banks can be unusually tight. At the year end the Company had £4.4m receivable and £52.3m payable relating to financial instruments with bank counterparties.

Dividend policy

The Company's policy is to distribute to its shareholders any available surplus funds, after taking into account the cash requirements needed to continue to invest in the business and the Company's level of gearing, and subject to the availability of distributable profits.

Accounting policies

The Company's accounting policies are set out in note 1 to the financial statements. These accounting policies have been applied consistently during the year and in the preceding year.

Operational review

Safety

Injury performance

The Company's overriding goal is to distribute gas safely and reliably and to ensure a safe workplace for its workforce with everyone striving towards eliminating injuries. This year the lost time injury performance rate increased slightly to 0.13 injuries per 100,000 hours (2016: 0.06).

Board responsibility

The Board has a Safety, Health and Environmental Advisory Committee that is responsible for monitoring health and safety performance and ensuring the health and safety policy statement is adhered to. The Committee provides the Board with reports on any key areas identified and further details on the Committee are set out on page 17 in the Corporate Governance Statement.

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Strategic report for the year ended 31 March 2017 (continued)

Gas mains replacement programme

The Company replaces the iron pipes with modern polyethylene pipes to improve the safety of the existing network. Replacement expenditure, primarily of iron pipes, increased to £177.4m (2016: £158.3m).

Gas escapes standards of service

The Company's engineers respond to reports of suspected gas leaks 24 hours a day, 365 days a year, regardless of from whom people buy their gas. Its engineers aim to attend all uncontrolled gas escapes within one hour and all controlled gas escapes within two hours. A controlled gas escape is one where the person reporting it has confirmed that the gas emergency control valve serving the premises has been turned off and the smell of gas has gone. An uncontrolled gas escape covers all others. The Company's engineers exceeded Ofgem targets by attending over 98% of uncontrolled gas escapes within one hour.

Gas networks' regulation

Gas network companies are subject to economic regulation through Price Control Reviews set by industry regulator Ofgem. The current eight year price control (RIIO) commenced in April 2013 and runs through until March 2021.

Revenues are earned through charges levied on network users, to cover costs and earn a return on the network company's regulated assets. Ofgem also has incentives in the price control to encourage greater efficiency, innovation and delivery of an enhanced standard of service for customers.

With three years of RIIO complete the Company has performed well on outputs set by the regulator, including those for innovation, customer satisfaction and stakeholder engagement.

Further details

Further details on the long term development plans of the Company can be found in the long term development statement (published in accordance with Special Condition D3 of the Gas Transporter Licences) and available on the Company's website - www.sgn.co.uk. The long term development plans set out the forecast gas demand over the ten year period and outlines the capital investment plan that is required to ensure the continued operation of the network in accordance with the Company's licence conditions.

Approved by the Board of Directors and signed on its behalf by:



Gregor Alexander
Chairman

18 July 2017

Southern Gas Networks plc

Directors' report for the year ended 31 March 2017

The Directors present their report and the audited financial statements for the year ended 31 March 2017.

Principal activities

The Company's principal activity is the development, administration, maintenance and operation of the South and South East of England gas distribution system and the supply of transportation services. It will continue in this activity for the foreseeable future.

Directors

The Directors of the Company who served during the year ended 31 March 2017 and up to date of signing are listed below:

Gregor Alexander (Chairman)
Robert McDonald
James McPhillimy (resigned 26 Oct 2016)
Guy Lambert (appointed 26 Oct 2016)
Kenton Edward Bradbury (appointed 26 May 2016)
Olivia Steedman (resigned 26 May 2016)
Natalie Flageul
John McManus
Neil Fleming
Alejandro Lopez Delgado
Andrew Jonathan Mark Taylor (appointed 26 May 2016)
Graham Juggins
Paul Jeffery

Directors' insurance and indemnities

The Directors of the Company have the benefit of the indemnity provisions in the Company's Articles of Association. The Directors have been granted a qualifying third party indemnity provision which was in force throughout the year. In addition, SGN has purchased and maintained throughout the year Directors' and officers' liability insurance in respect of itself, the Group, the Directors and other senior executives of the Group.

Review of business

The review of business for the year, including an analysis using key performance indicators, together with a description of the principal risks and uncertainties facing the Company are set out in the strategic report on pages 2 to 9.

Future developments

Details of future developments can be found in the strategic report on pages 2 to 9.

Results and dividends

The profit and loss account is set out on page 25, and is also reviewed on page 7.

The Company paid an interim dividend of £135.0m (2016: £nil). The Directors do not propose payment of a final dividend (2016: £nil).

Financial risk management

The Company's funding, liquidity and exposure to interest rate and foreign exchange risks are managed within a framework of policies and guidelines authorised by the Board of Directors.

Southern Gas Networks plc

Directors' report for the year ended 31 March 2017 (continued)

Interest rate risk

The Company has interest bearing liabilities, and as a matter of policy a minimum of 75% of debt is maintained at either fixed rates of interest or index linked. This policy is kept under review from time to time. The Company uses interest rate swaps, where necessary, in order to achieve this desired profile.

Liquidity risk

The Company maintains a mixture of long term funding and short term liquid funds in order to ensure that there are sufficient funds available for the Company's current and planned operations.

Foreign exchange risk

All of the Company's borrowings are currently denominated in Pound Sterling, so there is no foreign exchange risk. However, in accordance with its policy, should the Group decide to raise finance in currency other than Pound Sterling, cross currency swaps would be used to fully hedge the borrowings into Pound Sterling.

Credit risk

The Company transacts with banks for the provision of interest rate and currency hedging transactions. The Company takes reasonable steps to maintain a minimum credit rating requirement as set out in its hedging policy; however, it recognises that at times the market conditions for banks can be unusually tight. In respect of short term cash management, counterparties are subject to review and approval according to defined criteria.

Trade receivables predominantly relate to transportation income from gas shippers. Credit risk arising from the Group's regulated business is managed in accordance with industry standards as set out by the Unified Network Code. The Group contracts with shippers having investment grade ratings only, or where suitable collateral or cash prepayments are made. Credit risk on amounts receivable from other Group companies is considered minimal.

Pricing risk

The Company's gas transportation charges are subject to price control formulae set within the regulatory regime. The Company's maximum allowed revenue in a given price period is dependent upon a number of factors that are not known in advance and therefore the maximum allowed annual revenue is not known until the end of the relevant period. However, transportation tariffs are set on a prospective basis based upon expected transportation volumes, so actual revenue received or receivable in any one year may differ from the maximum allowed revenue. Where revenues received or receivable differ from the maximum allowed annual revenue, adjustments are made to future prices to reflect this over or under recovery.

Employees

The Company places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the Company. Participation by employees generally is encouraged through team meetings, briefings, an internal newspaper and an intranet site. Employee representatives are consulted regularly on a wide range of matters affecting their current and future interests.

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

Southern Gas Networks plc

Directors' report for the year ended 31 March 2017 (continued)

Going concern

The Company's financial position, cash flows, liquidity position and borrowing facilities together with the factors likely to affect its future performance and the principal risks and uncertainties are set out in the strategic report on pages 2 to 9. The financial risk management objectives and risk exposures are set out above.

As stated in the strategic report the Company operates the regulated gas distribution networks in the South and South East of England. The revenue of the Company is regulated by Ofgem via established price control mechanisms. The Company has considerable financial resources together with committed financing facilities to finance the current and future operations. The Company's forecasts and projections, taking account of reasonably possible changes in trading performance show that the Company should be able to operate within the level of its current facilities. As a consequence, the Directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook. After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

Environment and Carbon Reporting

The main challenges facing us this year have been to adapt our Environmental Management System (EMS) to the new ISO14001 standard and to continue to deliver the environmental performance improvements required of our Greenplan impact reduction strategy.

We have achieved ISO14001 2015 by the spring of 2017, 17 months ahead of the deadline. In order to obtain this new accreditation we have had to make significant adaptations to a number of key documents which make up our EMS.

Following a three stage independent audit undertaken in March/April of this year it was confirmed that we have fully met the new requirements and so have been successful in achieving the new accreditation, by our targeted date.

Greenplan, which began in 2013-14 has now reached the half way stage in line with our eight year PCR. Its five goals are underpinned by nine targets which are measured and reported on every month. We have reviewed the last four years performances and have adjusted the targets for the second four year period to ensure they remain realistic, achievable but also stretching.

Despite tightening targets since 2008, at the end of year four, we have met six of our nine targets.

Significant benefits deriving from Greenplan this year have included a reduction in our business carbon footprint, energy usage, and the proportion of spoil we have sent to landfill.

Aspects

An aspect is the element of an organisation's activities, products or services that can interact with the environment. Each aspect is assigned a risk assessment score and action plan. These are reviewed to improve performance and meet ISO14001 requirements. To enhance this process we have changed how we review our twelve aspects. Each aspect now has an associated expert - a lead aspect manager. The assessment scores will be reviewed individually with these experts and take account of action plan performances and associated Greenplan evidence.

Southern Gas Networks plc

Directors' report for the year ended 31 March 2017 (continued)

Energy monitoring and reduction systems

During the last 12 months we've monitored the results of a trial in which we installed a real time energy monitoring system at one of our depots. This has proved successful in facilitating energy reductions which has lead us to install a similar system at one of our newly built depots. The second system hardware and communications have been fully integrated into the electrical and IT designs at an early stage. This approach is likely to deliver additional benefits compared to the "bolt on" original trial. The system enables monitoring of individual circuits to pinpoint anomalous usage. After implementation, further energy reduction investments can be reviewed.

RIIO annual reporting

Each year we report to Ofgem on business carbon footprint, volume and percentage of excavated spoil which reaches landfill and the volume and percentage of total reinstatement material that is made up of virgin material.

The largest element of our business carbon footprint stems from our natural gas emissions. Strenuous efforts have been made to reduce these as described in last year's report. Since the first year of Greenplan in 2013/14 we have reduced our natural gas emissions a further 6.7%.

Greenplan four year benefits

We strive to make our data more accurate and inclusive and this year we have included hire car data for the first time.

Since 2012/13 we have reduced our:

- Scope 1 & 2 carbon emissions (those over which we have direct control) by 18.0%
- Percentage of excavated spoil reaching landfill from 2.0% to 0.1%
- Percentage of reinstatement material containing virgin aggregate from 3.4% to 2.1%

	2016/17		2015/16		Annual Movement Decrease/(increase)	
	Tonnes of CO ₂	Tonnes of CO ₂ per £1m turnover	Tonnes of CO ₂	Tonnes of CO ₂ per £1m turnover	Tonnes of CO ₂	Tonnes of CO ₂ per £1m turnover
Scope 1						
Energy consumption (excluding electricity)	221	0.29	119	0.16	(102)	(0.13)
Transport (direct commercial vehicles and business miles)	10,512	13.87	9,990	13.56	(522)	(0.31)
Scope 2						
Electricity consumption	2,633	3.47	2,921	3.96	288	0.49
Scope 3						
Rail, air and ferry travel	12,732	16.80	12,991	17.63	259	0.83
Total (excluding shrinkage)	26,098	34.43	26,021	35.31	(77)	0.88
Shrinkage	584,441	771.03	607,156	823.93	22,715	52.90
Total carbon emissions	610,539	805.46	633,177	859.24	22,638	53.78

Data has not been independently verified.

Southern Gas Networks plc

Directors' report for the year ended 31 March 2017 (continued)

Auditor

Each of the Directors at the date of this report confirms that:

- 1) So far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- 2) The Director has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provision of section 418 of the Companies Act 2006.

By Order of the Board

A handwritten signature in black ink, appearing to be 'Nicola Shand', with a stylized, wavy line extending from the end.

Nicola Shand
Company Secretary

18 July 2017

Southern Gas Networks plc

Corporate governance statement

The Board of Directors is the principal decision making forum for the Company and is committed to the highest standards of corporate governance. The Board believes that strong governance improves the performance of the Group and enhances shareholder value. This report sets out the key governance principles and practices of the Company and of the Group.

The Company, not having listed equity shares, is not subject to the UK Financial Reporting Council's Combined Code on Corporate Governance¹ (the "**Combined Code**"), and the Board of Directors does not believe that all of the guidance set out in the Combined Code is applicable to the Company. However, for the purposes of this statement, the Directors have applied the Combined Code insofar as they believe it to be applicable.

Board of Directors

The Board of Directors is comprised entirely of non-executive Directors and is the principal decision-making forum for the Company. Directors are nominated to the Board in accordance with the terms of the Shareholders' and Governance Agreement.

The Board is collectively responsible to the Company's shareholders for the long term success of the Group and for its overall strategic direction, its values and its governance. It provides the leadership necessary for the Group to meet its business objectives whilst ensuring that a sound system of internal control and risk management is in place.

The powers and the duties of the Directors are determined by legislation and by the Company's Articles of Association. The Board has also adopted a formal schedule of matters detailing key aspects of the Company's affairs reserved to it for decision. Furthermore, the Board has established three standing committees and one non standing committee with specific responsibilities to ensure focused and effective leadership. Details of the committees are set out below.

The Board meets regularly and has held twelve meetings during the year.

Board Constitution and Appointments

The Board of Directors consists of seven non-executive Directors in addition to the non-executive Chairman. The Board of Directors is the same for the Company and each company within the Group, except for Scotland Gas Networks plc and Southern Gas Networks plc which consist of two additional independent non-executive Directors.

Each of the non-executive Directors is chosen for their diversity of skills and experience.

The non-executive Directors scrutinise, measure and review the performance of management; constructively challenge and assist in the development of strategy; review the Group financial information and ensure systems of internal control and risk management are appropriate and effective.

Biographical details for each of the Directors are set out on pages 19 to 20.

Chairman

Gregor Alexander was re-appointed as Chairman on 24 July 2014 for a further three year period.

¹ The UK Corporate Governance Code was issued in May 2010 (replacing the Combined Code on Corporate Governance), applies to financial years beginning on or after 29 June 2010 and is available on the Financial Reporting Council's website (www.frc.org.uk).

Southern Gas Networks plc

Corporate governance statement (continued)

Chief Executive Officer and Chief Financial Officer

Below the Board, executive responsibility rests with John Morea, Chief Executive Officer ("CEO") and Chris Brook, Chief Financial Officer ("CFO"). The CEO and CFO are each employed by the Group and are not Directors of the Company. They are supported by an executive committee which meets on a monthly basis and is responsible for managing the day-to-day operations of the Group.

Biographical details for the CEO and CFO are set out on page 20.

Timeliness and quality of Board information

The Board has sought to ensure that Directors are properly briefed on issues arising at board meetings by establishing procedures for distributing board papers one week in advance of meetings; considering the adequacy of the information provided before making decisions; adjourning meetings or deferring decisions when Directors have concerns about the information available to them and making the Company Secretary responsible to the Board for the timeliness and quality of information.

All Directors have access to the advice and services of the Company Secretary.

Conflicts of interest

With effect from 1 October 2008, the Companies Act 2006 has introduced a statutory duty on Directors to avoid conflicts of interest. During the year, the Company Secretary reviewed all of the Directors' reported actual and potential conflicts of interest and the Board then considered and recorded each Director's reported actual and potential conflicts of interest.

The Board has put into place a procedure to consider any future actual or potential conflicts of interest that the Directors may have and will review the position regularly.

Board Committees

In order to provide effective and focused leadership, the Board has established three standing committees and one non standing committee with specific responsibilities. These are the Audit Committee, the People and Reward Committee and the Safety, Health and Environmental Advisory Committee (standing) and the Finance Committee (non standing).

Each Committee's performance, constitution and terms of reference are reviewed annually to ensure that they are operating effectively. The Company Secretary acts as secretary for each committee and further details are set out below.

Audit Committee

The current members of the Audit Committee are John McManus (Committee Chairman), Graham Laughland (appointed in 2009 as independent member of the Audit Committee), Gregor Alexander, Neil Fleming and Guy Lambert.

The principal responsibilities of the Audit Committee are as follows:-

- Ensuring that the Company's financial reports represent an accurate, clear and balanced assessment of the Company's position and prospects;
- Ensuring the economy, efficiency and effectiveness of the Company's operations and internal controls, the reliability and integrity of information and accounting systems, and the implementation of established policies and procedures;
- Monitoring and reviewing the Company's internal audit function; and
- Maintaining a close relationship with the Company's external auditor and reviewing the effectiveness of the external audit process.

As part of its activities, the Audit Committee also reviews and approves key regulatory filings prior to their issue to Ofgem.

Southern Gas Networks plc

Corporate governance statement (continued)

The Chairman of the Audit Committee reports to the Board of Directors following each committee meeting on the main areas and subjects the Committee has reviewed such as risk management, internal control, internal audit reports and any issues arising from its review of the financial statements.

The Board considers that the membership of the Audit Committee as a whole has sufficient recent and relevant financial experience to discharge its functions. The Committee met three times during the year.

Safety, Health and Environmental Advisory Committee

The current members of the Safety, Health and Environmental Advisory Committee are Natalie Flageul, Andrew Jonathan Mark Taylor, Graham Juggins, Alejandro Lopez Delgado, John Morea (Chief Executive Officer) and Gary Barnes (Director of Corporate Services).

The principal responsibilities of the Safety, Health and Environmental Advisory Committee are as follows:

- Ensuring that the health and safety policy statement and environmental policy statement remain fit for purpose and are being adhered to;
- Reviewing and monitoring the safety, health and environmental strategy and action plan, which shall be designed to eliminate, reduce or otherwise control personal and process related data;
- Reviewing and monitoring the safety, health and environmental compliance and assurance plan (and liaising with the internal auditors in relation thereto);
- Setting health and safety, and environmental targets to improve the Group's performance;
- Monitoring health and safety and environmental performance against planned targets and identified key improvement areas by means of appropriate leading and lagging key performance indicators; and
- Encouraging greater awareness of the importance of health, safety and the environment and higher achievement in performance in these areas.

The Chairman of the Safety, Health and Environmental Advisory Committee reports to the Board of Directors following each committee meeting on the main areas and subjects the Committee has reviewed. Three meetings were held during the year.

People and Reward Committee

The current members of the People and Reward Committee are Andrew Jonathan Mark Taylor (Committee Chairman), John McManus and Gregor Alexander.

The principal responsibilities of the People and Reward Committee are as follows:-

- To determine and agree with the Board of Directors the Group's framework or broad policy for executive and senior management remuneration. The Committee has delegated authority for setting the remuneration of the CEO, CFO and their direct reports; and
- To review the ongoing appropriateness and relevance of the remuneration policy.

The Chair of the People and Reward Committee reports to the Board of Directors following each Committee meeting on the remuneration matters which the Committee has reviewed. Three meetings were held during the year.

Southern Gas Networks plc

Corporate governance statement (continued)

Finance Committee

The current members of the Finance Committee are Neil Fleming, Guy Lambert, Gregor Alexander and Alejandro Lopez Delgado.

The principal responsibility of the Finance Committee is to authorise specific transactions of the Group where it has been provided delegated authority by the Board of Directors to do so.

The members of the Finance Committee report to the Board of Directors following each Committee meeting on the matters which the Committee has reviewed. Four meetings were held during the year.

Board and Committee Performance Evaluations

During the year, the Board has undertaken a comprehensive evaluation of its own performance and that of its three Committees and individual Directors. This was conducted internally using detailed questionnaires which the Chairman then discussed with each Director and the Company Secretary. The Board has considered and discussed the outcomes of the evaluations and is satisfied that it is operating well and focused on the correct strategic issues. The Directors continue to review the Board's performance and that of its three Committees and individual Directors on an annual basis.

Attendance at Board and Board Committee meetings

The attendance of the Board of Directors and the Board Committees during the year is as set out below.

	Board meetings		Audit Committee meetings		People and Reward Committee meetings		Safety, Health and Environmental Committee meetings		Finance Committee meetings	
	Attended	Possible	Attended	Possible	Attended	Possible	Attended	Possible	Attended	Possible
Gregor Alexander	12	12	3	3	1	1	-	-	4	4
Robert McDonald	10	12	3	3	-	-	-	-	-	-
James McPhillimy**	4	4	-	-	2	2	1	1	-	-
Alejandro Lopez Delgado	11	12	-	-	-	-	3	3	3	4
Olivia Steedman*	2	2	1	1	1	1	-	-	-	-
Natalie Flageul	10	12	-	-	-	-	2	2	-	-
John McManus	10	12	3	3	3	3	-	-	-	-
Neil Fleming	12	12	2	2	1	1	2	3	4	4
Andrew Jonathan Mark Taylor*	7	11	-	-	1	2	-	2	-	-
Guy Lambert**	7	7	-	-	-	-	-	-	1	1
Paul Jeffery	10	12	-	-	-	-	-	-	-	-
Graham Juggins	8	12	-	-	-	-	-	-	-	-
Graham Laughland***	n/a	n/a	2	3	n/a	n/a	n/a	n/a	n/a	n/a

* Andrew Jonathan Mark Taylor was appointed as director on 26 May 2016, Olivia Steedman resigned as director on the same date.

** Guy Lambert was appointed as director on 26 October 2016, James McPhillimy resigned as director on the same date.

*** Graham Laughland is not a member of those committees.

Southern Gas Networks plc

Corporate governance statement (continued)

Internal Controls in relation to the Company's financial reporting process

The Board of Directors is ultimately responsible for the Group's internal control systems and risk management. The Group's system of internal control and embedded risk management, which has been in place throughout the year, helps to safeguard the assets and is designed to manage, rather than eliminate, material risks to the achievement of the business objectives. The Board recognises that these systems can provide only reasonable, and not absolute, assurance against material misstatement or loss.

Accordingly, the Directors have regard to what controls, in their judgement, are appropriate to the business, to the materiality of the risks inherent in the business, and to relative costs and benefits of implementing specific controls.

Internal control is maintained through an organisation structure with clearly defined responsibilities, authority levels and lines of reporting, the appointment of suitably qualified staff in specialised business areas, and continuing investment in high quality information systems. These methods of control are subject to periodic review as to their implementation and continued suitability.

There were no changes in the Company's internal controls over financial reporting during the year covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Internal audit

The 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 Board. The internal audit manager reports to the Audit Committee on the audit programme, progress against the programme and any follow-up actions on a bi-monthly basis.

Directors' and Senior Executives' Biographies and Responsibilities

Gregor Alexander, Chairman

Gregor joined the Board of the Company at its inception and was appointed Chairman in July 2011. He is Finance Director of SSE plc and previously worked with the accountancy firm Arthur Andersen. He is a member of the Audit Committee, the People and Reward Committee, and the Finance Committee.

Robert McDonald, Director

Robert joined the Board of the Company in July 2006. He is Managing Director, Corporate and Business Services at SSE plc and has previously worked with the industry's regulatory body.

Alejandro Lopez Delgado, Director

Alejandro joined the Board in November 2015. He is a Director at Borealis Infrastructure, where he is responsible for the origination, acquisition and management of infrastructure investments, with a focus in Europe. He is a member of the Safety, Health and Environmental Advisory Committee and the Finance Committee.

Andrew Jonathan Mark Taylor, Director

Jo Taylor joined the Board in May 2016. He is Regional Managing Director, EMEA, overseeing the full cycle of origination, analysis, execution, value creation and eventual realization of private investments in EMEA. Jo is the Chairman of the People and Reward Committee and a member of the Safety, Health and Environmental Advisory Committee.

John McManus, Director

John joined the Board of the Company in March 2012. He is Senior Advisor to OMERS Private Markets and the Borealis leadership team in infrastructure asset management, assessment of investment opportunities, relationship development and mentorship. He is the Chairman of the Audit Committee and a member of the People and Reward Committee.

Southern Gas Networks plc

Corporate governance statement (continued)

Natalie Flageul, Director

Natalie joined the Board of the Company in September 2011. She is Director of Metering at SSE plc and over the past five years has overseen the transformation to nationwide coverage in preparation for Smart Meter deployment. She is a member of the Safety, Health and Environmental Advisory Committee.

Neil Fleming, Director

Neil joined the Board in March 2015 and is a Senior Principal in Teachers' Infrastructure Group. He is active in the regulated utilities and transportation sectors in Europe. He is a member of Audit Committee, and the Finance Committee.

Guy Lambert, Director

Guy joined the Board in October 2016. He joined the Abu Dhabi Investment Authority (ADIA) in 2008 and currently serves as the Head of Utilities. He is responsible for sourcing and executing new investments in the utilities sector and overseeing the existing utilities portfolio. Guy is a member of the Audit Committee and the Finance Committee.

Kenton Edward Bradbury, Alternate Director

Kenton joined the board in May 2016. He is a managing director in asset management at Borealis and is responsible for the active management of infrastructure investments, with a focus on Europe. Kenton was appointed as an alternate director. He attends board meetings as a substitute to Alejandro.

Graham Juggins, Director

Graham joined the Board as an independent non-executive Director in January 2014. He is an electrical engineer and has 38 years of experience in the energy and construction industries holding senior posts, which include Director of Human Resources at SSE plc.

Paul Jeffery, Director

Paul joined the Board as an independent non-executive Director in January 2014. Previously he ran the European Power, Utility and Infrastructure Investment Banking Sector team for Barclays. Paul is also a non - executive Director of UK Power Networks and Seata Yield S.A.

John Morea, Chief Executive Officer

John joined the Company in May 2005 from SSE plc. He has over 20 years' experience within the utilities industry. John is a companion of the Institute of Gas Engineers and Managers, a member of the Institute of Engineering and Technology and holds an MBA.

Chris Brook, Chief Financial Officer

Chris joined the Company in September 2008. Chris was previously Finance Director of United Utilities Water, the regulated water business, before joining the Company. Chris is a Chartered Accountant having trained and qualified with Touche Ross.

Nicola Shand, Company Secretary

Nicola joined the Board as Company Secretary in July 2011. She is the Company Secretary and Director of legal and compliance and is responsible to the Board for compliance with Board procedures and for advising and keeping the Board up to date on all corporate governance developments.

Southern Gas Networks plc

Directors Responsibilities Statement

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland". Under Company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

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

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

Signed on behalf of the Board of Directors of Southern Gas Networks plc:



Gregor Alexander
Chairman

18 July 2017

Southern Gas Networks plc

Independent auditor's report to the members of Southern Gas Networks plc

Report on the audit of the financial statements

Opinion

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 March 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice 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 of Southern Gas Networks plc (the 'Company') which comprise:

- the profit and loss account;
- the statement of comprehensive income;
- the balance sheet;
- the statement of changes in equity;
- the significant accounting policies; and
- the related notes 1 to 22.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, 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 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.

Southern Gas Networks plc

Independent auditor's report to the members of Southern Gas Networks plc (continued)

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 this regard.

Responsibilities of directors

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

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

Auditor's responsibilities for the audit of the financial statements

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

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

Southern Gas Networks plc

Independent auditor's report to the members of Southern Gas Networks plc (continued)

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.

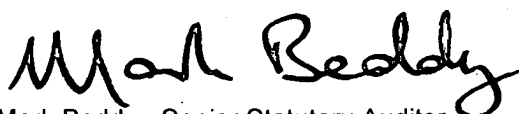
In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

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.



Mark Beddy - Senior Statutory Auditor
for and on behalf of Deloitte LLP
Statutory Auditor
2 New Street Square
London
EC4A 3BZ
United Kingdom
18 July 2017

Southern Gas Networks plc

Profit and loss account for the year ended 31 March 2017

	Notes	2017 £m	2016 £m
Turnover	3	758.0	736.9
Net operating costs	3	(408.3)	(373.5)
Operating profit	3	349.7	363.4
Income from fixed asset investments	12	-	0.7
Interest receivable and similar income	4	5.4	5.8
Interest payable and similar charges	5	(111.4)	(116.5)
Profit on ordinary activities before taxation	6	243.7	253.4
Tax (charge)/credit on profit on ordinary activities	8	(3.1)	15.0
Profit for the financial year	18	240.6	268.4

The above results relate to continuing operations in both the current and previous year.

The notes on pages 27 to 58 form an integral part of the financial statements.

Southern Gas Networks plc

Statement of comprehensive income for the year ended 31 March 2017

	Notes	2017 £m	2016 £m
Profit for the financial year	18	240.6	268.4
Cash flow hedges:			
- Gains arising on cash flow hedges	18	0.7	8.9
Remeasurement of net defined benefit asset	20	(38.9)	60.7
Deferred tax movement relating to components of other comprehensive income:			
- Cash flow hedges	18	-	(1.6)
- Pension asset		6.2	(13.0)
Other comprehensive (loss)/income		(32.0)	55.0
Total comprehensive income		208.6	323.4

Southern Gas Networks plc

Balance sheet as at 31 March 2017

	Notes	2017 £m	2016 £m
Fixed assets			
Intangible assets	10	258.5	271.3
Tangible assets	11	4,068.0	3,921.0
Investments	12	0.2	0.2
		4,326.7	4,192.5
Current assets			
Debtors	13	968.5	939.6
Cash at bank and in hand		7.0	2.6
		975.5	942.2
Creditors: amounts falling due within one year	14	(212.2)	(202.3)
Net current assets		763.3	739.9
Total assets less current liabilities		5,090.0	4,932.4
Creditors: amounts falling due after more than one year	15	(2,668.6)	(2,572.9)
Provisions for liabilities	16	(542.8)	(596.3)
Deferred income	11	(186.7)	(172.9)
Net assets excluding pension asset		1,691.9	1,590.3
Defined benefit pension asset	20	2.9	30.9
Net assets		1,694.8	1,621.2
Capital and reserves			
Called up share capital	18	160.2	160.2
Hedge reserve	18	(1.6)	(2.3)
Profit and loss account	18	1,536.2	1,463.3
Shareholder's funds		1,694.8	1,621.2

The financial statements of Southern Gas Networks plc, registered number 05167021 were approved by the Board of Directors on 18 July 2017 and signed on its behalf by:



Gregor Alexander
Chairman



Neil Fleming
Director

Southern Gas Networks plc

Statement of changes in equity for the year ended 31 March 2017

	Notes	Called up share capital £m	Hedge reserve £m	Profit and loss account £m	Total £m
At 1 April 2015		160.2	(9.6)	1,147.2	1,297.8
Profit for the financial year		-	-	268.4	268.4
Cash flow hedges		-	8.9	-	8.9
Remeasurement of net defined benefit pension asset		-	-	60.7	60.7
Deferred tax movements relating to items of other comprehensive income:					
- Cash flow hedges		-	(1.6)	-	(1.6)
- Pension liability		-	-	(13.0)	(13.0)
Total comprehensive income		-	7.3	316.1	323.4
At 31 March 2016		160.2	(2.3)	1,463.3	1,621.2
Profit for the financial year		-	-	240.6	240.6
Cash flow hedges	18	-	0.7	-	0.7
Remeasurement of net defined benefit pension asset	20	-	-	(38.9)	(38.9)
Deferred tax movements relating to items of other comprehensive income:					
- Cash flow hedges	18	-	-	-	-
- Pension asset		-	-	6.2	6.2
Total comprehensive income		-	0.7	207.9	208.6
Dividends paid		-	-	(135.0)	(135.0)
At 31 March 2017		160.2	(1.6)	1,536.2	1,694.8

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

1 Significant accounting policies

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

a. General information and basis of preparation

Southern Gas Networks Plc is a private limited Company incorporated in the United Kingdom under the Companies Act 2006. The address of the registered office is St Lawrence House, Station Approach, Horley, Surrey, RH6 9HJ. The Company's principal activity is the development, administration, maintenance and operation of the South and South East of England gas distribution system and the supply of gas transportation services.

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 – 'The Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland' (FRS 102) issued by the Financial Reporting Council. There were no material departures from that standard.

The functional currency of Southern Gas Networks Plc is considered to be pounds sterling because that is the currency of the primary economic environment in which the Company operates. Amounts are expressed in millions of pounds except where noted otherwise.

The Company is a wholly owned subsidiary of Scotia Gas Networks Limited and the financial statements of the Company are included in the consolidated financial statements of Scotia Gas Networks Limited which can be obtained from the address above. Consequently, the Company has taken exemptions available under FRS 102 in relation to financial instruments, presentation of a cash flow statement, intra-group transactions and remuneration of key management personnel.

b. Going concern

After reviewing the Company's forecasts and projections, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements. See also director's report for discussion on going concern.

c. Intangible assets – goodwill

Goodwill arising on the acquisition of businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight line basis over its useful economic life, which is estimated to be 50 years. Provision is made for any impairment, and it is tested on an annual basis at each balance sheet date.

d. Intangible assets – software

Software assets are included at cost, net of amortisation and any provision for impairment. Amortisation is provided in equal annual instalments over a period of 3 to 10 years, which is their estimated useful economic life.

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

1 Significant accounting policies (continued)

e. Tangible fixed assets

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Depreciation is provided on all tangible fixed assets, other than freehold land, at rates calculated to write off the cost or valuation, less estimated residual value, of each asset on a straight-line basis over its expected useful life, as follows:

Freehold buildings:	Up to 50 years
Leasehold land and buildings:	Over the shorter of lease term and 50 years
Plant and machinery:	
-Mains and services:	55 to 65 years
-Regulating equipment:	30 to 50 years
-Gas storage:	40 years
-Motor vehicles and office equipment:	3 to 10 years
Site remediation costs are depreciated over the life of the asset.	

Replacement expenditure is capitalised within mains and services and depreciated accordingly above.

Residual value represents the estimated amount which would currently be obtained from disposal of an asset, after deducting estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

f. Fixed asset investments

Fixed asset investments are stated at cost less a provision for any impairment in value. Costs of the investments include all costs directly related to the acquisition of the investments.

g. Impairment of non-financial assets

Assets, other than those measured at fair value, are assessed for indicators of impairment at each balance sheet date. If there is objective evidence of impairment, an impairment loss is recognised in profit or loss as described below.

An asset is impaired where there is objective evidence that, as a result of one or more events that occurred after initial recognition, the estimated recoverable value of the asset has been reduced. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use.

The recoverable amount of goodwill is derived from measurement of the present value of the future cash flows of the business. Any impairment loss is allocated first to the goodwill, and then to other assets on a pro-rata basis. The Company considers there to be no one CGU for the purpose of goodwill impairment.

Where indicators exist for a decrease in impairment loss, the prior impairment loss is tested to determine reversal. An impairment loss is reversed on an individual impaired asset to the extent that the revised recoverable value does not lead to a revised carrying amount higher than the carrying value had no impairment been recognised. Where a reversal of impairment occurs, the reversal is applied to the assets (other than goodwill) on a pro-rata basis. Goodwill impairment is not reversed.

h. Taxation

Current tax, including UK corporation 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 timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

1 Significant accounting policies (continued)

h. Taxation (continued)

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 arises 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 measured using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date that are expected to apply to the reversal of the timing difference.

Where items recognised in other comprehensive income or equity are chargeable to or deductible for tax purposes, the resulting current or deferred tax expense or income is presented in the same component of comprehensive income or equity as the transaction or other event that resulted in the tax expense or income.

Current tax assets and liabilities are offset only when there is a legally enforceable right to set off the amounts and the Company intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Deferred tax assets and liabilities are offset only if: a) the Company has a legally enforceable right to set off current tax assets against current tax liabilities; and b) the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

i. Turnover

Turnover is stated net of value added tax and is attributable to the continuing activity of transportation of natural gas and the provision of related services. Turnover is recognised to the extent that there is a right to consideration and is recorded at the value of the consideration due. Turnover includes an assessment of transportation services supplied to customers between the date of the last meter reading and the year end.

Where revenues received or receivable differ from the amount permitted by regulatory agreements, adjustments will be made to future prices to reflect this over or under recovery.

j. Employee benefits

i. Defined benefit pension scheme

For defined benefit schemes the amounts charged to operating profit are the costs arising from employee services rendered during the year and 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.

Defined benefit schemes are funded, with the assets of the scheme held separately from those of the Company, in separate trustee administered funds. Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit credit method. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date.

A surplus was recognised due to change in actuarial assumptions. It is probable that the surplus recognised will result in reduced amount of future contributions to the scheme or in the form of

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

1 Significant accounting policies (continued)

j. Employee benefits (continued)

refund from the scheme. Since the amount recognised is within the cap allowed under regulation, management deem the recognition of surplus appropriate.

ii. Defined contribution pension scheme

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

k. Foreign currency

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date.

Other exchange differences are recognised in profit or loss in the year in which they arise except for exchange differences on transactions entered into to hedge certain foreign currency risks (see below), and exchange differences arising on gains or losses on non-monetary items which are recognised in other comprehensive income.

l. Leases

i. Finance leases

Assets held under finance leases, hire purchase contracts and other similar arrangements, which confer rights and obligations similar to those attached to owned assets, are capitalised as tangible fixed assets at the fair value of the leased asset (or, if lower, the present value of the minimum lease payments as determined at the inception of the lease) and are depreciated over the shorter of the lease terms and their useful lives. The capital elements of future lease obligations are recorded as liabilities, while the interest elements are charged to the profit and loss account over the period of the leases to produce a constant periodic rate of interest on the remaining balance of the liability.

ii. Operating leases

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis. Benefits received and receivable as an incentive to sign an operating lease are similarly spread on a straight-line basis over the lease term.

m. Borrowing costs capitalised

Borrowing costs which are directly attributable to the construction of qualifying tangible fixed assets are capitalised as part of the cost of those assets. Qualifying tangible fixed assets are considered to be those of significant size or complexity, which typically are under construction for in excess of one year and/or where project costs exceed a pre-determined threshold. 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. Borrowing costs are not capitalised in respect of construction projects which do not meet the defined thresholds or relate to replacement expenditure.

n. Grants and contributions

Customer contributions for connections to the network and for replacement expenditure diversions are capital grants. NIC grants are considered revenue grants.

Capital grants and customer contributions in respect of additions to fixed assets are treated as deferred income and released to the profit and loss account over the estimated useful lives of the related assets.

Revenue grants and contributions are credited to the profit and loss account in the year to which they relate.

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

1 Significant accounting policies (continued)

n. Grants and contributions (continued)

Deferred income in respect of both revenue grants and contributions is included separately on the face of the balance sheet due their materiality. Other deferred income items which are not considered as material are shown separately in note 14.

o. Provisions

A provision is recognised in the balance sheet when the Company has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are discounted where the impact of discounting the expected future cash flows is material.

p. Financial instruments

FRS 102 sections 11 and 12 give an accounting policy choice for financial instruments. The Company has chosen to apply the recognition and measurement provisions of IAS 39 (as adopted for use in the EU) and the disclosure requirements of FRS 102 in respect of financial instruments.

Financial assets and financial liabilities are recognised when the Company becomes a party to the contractual provisions of the instrument.

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

The Company's funding, liquidity and exposure to interest rate risks are managed within a framework of policies and guidelines authorised by the Board of Directors. In accordance with these policies financial derivative instruments are used to manage interest rate and currency exposure.

Where appropriate these instruments are recorded at fair value and accounted for as described below.

i. Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset, or where appropriate, a shorter period.

Income and expense is recognised on an effective interest basis for debt instruments other than those financial assets designated as at 'fair value through profit or loss' (FVTPL).

ii. Financial Assets

Investments are recognised and derecognised on a trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned and are initially measured at fair value, plus transaction costs, except for those financial assets classified as FVTPL, which are initially measured at fair value.

Financial assets at the balance sheet date are classified into the following specified categories: financial assets at FVTPL, 'held-to-maturity' investments, 'available-for-sale' (AFS) financial assets and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

iii. Impairment of financial assets

For financial assets carried at amortised cost, the amount of an impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

1 Significant accounting policies (continued)

p. Financial instruments (continued)

For financial assets carried at cost less impairment, the impairment loss is the difference between the asset's carrying amount and the best estimate of the amount that would be received for the asset if it were to be sold at the reporting date.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade debtors.

Where indicators exist for a decrease in impairment loss, and the decrease can be related objectively to an event occurring after the impairment was recognised, the prior impairment loss is tested to determine reversal. An impairment loss is reversed on an individual impaired financial asset to the extent that the revised recoverable value does not lead to a revised carrying amount higher than the carrying value had no impairment been recognised.

iv. Derecognition of financial assets

The Company derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity.

v. Trade debtors

Trade debtors are initially recognised at fair value. The carrying amount is reduced through the use of provision. Appropriate provision for estimated irrecoverable amounts are recognised where the estimated cash flows are less than the carrying amount. Subsequent recoveries of amounts previously written off are credited against the provision account. Changes in the carrying amount of the provision account are recognised in profit or loss.

vi. Cash

Cash comprises cash on hand and demand deposits, which are those deposits, which are repayable on demand and available within 24 hours (one day) without penalty.

vii. Financial liabilities

Financial liabilities are classified as either financial liabilities at 'FVTPL' or 'other financial liabilities'.

viii. Financial liabilities at FVTPL

Financial liabilities are classified as at FVTPL where the financial liability is either held for trading or it is designated as at FVTPL.

A financial liability is classified as held for trading if:

- It has been incurred principally for the purpose of disposal in the near future; or
- It is a part of an identified portfolio of financial instruments that the Company manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and effective as a hedging instrument.

A financial liability other than a financial liability held for trading may be designated as at FVTPL upon initial recognition if:

- Such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- The financial liability forms part of a Company of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Company's documented risk management or investment strategy and information about the Company is provided internally on that basis; or
- It forms part of a contract containing one or more embedded derivatives and IAS 39 permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

1 Significant accounting policies (continued)

p. Financial instruments (continued)

Financial liabilities at FVTPL are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any interest paid on the financial liability.

ix. Other financial liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

x. De-recognition of financial liabilities

The Company derecognises financial liabilities when, and only when, the Company's obligations are discharged, cancelled or they expire.

xi. Derivative financial instruments and hedge accounting

The Company uses interest rate swaps and foreign exchange forward contracts to hedge interest rate and foreign currency risk arising on debt instruments. On inception of the hedge relationship the Company documents the relationships between the hedged item and the hedging instrument along with the risk management objectives and its strategy for undertaking various transactions. Furthermore, at inception of the hedge and on an ongoing basis the Company documents whether the hedging relationship is highly effective.

Changes in fair value of derivatives that are designated and are effective as hedges of future cash flows are recognised directly in equity within the hedge reserve. The ineffective portion of the hedge is recognised through the profit and loss account.

Changes in the fair value of derivatives that do not qualify for hedge accounting are recognised in the profit and loss account as they arise.

Hedge accounting is discontinued when the hedge instrument expires or is terminated.

Financial assets and financial liabilities are offset where they are settled net as a matter of practice and there is legal right to offset.

2 Critical accounting judgements and key sources of estimation uncertainty

In the application of the Company's accounting policies, which are described in note 1, the directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

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

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

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

Critical accounting judgements

- a. **Cost classification** – the allocation of overhead costs to capital investment projects is subject to accounting judgement, particularly around the amount of time spent on different activities. Guidelines have been established, and a Cost Allocation Model is used as part of a process to determine the split of attributable overheads between capital expenditure and operating expenditure.
- b. **Componentisation of replacement expenditure** – As set out in note 1, capitalised replacement expenditure is allocated to mains and services components with a range of useful economic lives between 55 and 65 years. On transition to FRS 102, all replacement expenditure incurred since 2005 has been assessed and allocated on an appropriate and relevant basis where replacement projects have involved multiple activities, judgement has been exercised to determine the appropriate accounts.

Key source of estimation uncertainty

- a. **Useful lives of assets and residual value** – in assessing the estimate of economic useful lives and residual value, consideration is given to the economic life of the gas industry. The depreciation policy is set out in note 1.
- b. **Retirement benefit schemes** - the assumptions used in accounting for the defined benefit pension scheme are based on estimates and are subject to uncertainties. These assumptions are set out in note 20 and include: the discount rate on scheme liabilities, mortality rates, pension increases, salary increases and inflation. The Company takes advice from independent actuaries on the appropriateness of these assumptions.
- c. **Valuation of financial instruments** – where financial instruments are recognised at fair value there are uncertainties in forward yield curves used in discounted cash flow calculations.
- d. **Environmental provision** – in assessing the degree of contamination at the various sites estimation is required where elements of the contamination are underground. In these cases, it is difficult to assess with any certainty the extent of the contamination. The discount rate is also a source of estimation. See note 16.
- e. **Revenue recognition** - Turnover includes an assessment of transportation services supplied to customers between the date of the last meter reading and the year end. Where revenues received or receivable differ from the amount permitted by regulatory agreements, adjustments will be made to future prices to reflect this over or under recovery.

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

3 Operating Profit

Turnover arises entirely in the United Kingdom and is attributable to the continuing activity of transportation of natural gas and the provision of related services, which the Directors consider a single class of business.

	2017 £m	2016 £m
Turnover	758.0	736.9
Distribution costs	(407.6)	(398.4)
(Loss)/profit on disposal of fixed assets	(4.9)	21.2
Other operating income	4.2	3.7
Total net operating costs	(408.3)	(373.5)
Operating profit	349.7	363.4

Distribution costs include all the costs of operating the distribution network together with depreciation and amortisation.

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

4 Interest receivable and similar income

	2017 £m	2016 £m
Interest receivable on loans to other Group undertakings	3.8	5.8
Net interest on defined benefit liability (see note 20)	1.6	-
	5.4	5.8

5 Interest payable and similar charges

	2017 £m	2016 £m
Index linked bond interest	17.1	15.4
Other interest payable on bonds	88.0	89.3
Other interest payable	2.1	7.5
Unwind of discount	1.0	2.5
Net interest on defined benefit asset (see note 20)	-	0.7
Movement in financial derivatives	3.2	1.1
	111.4	116.5

No borrowing costs have been capitalised during the year.

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

6 Profit on ordinary activities before taxation

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

	2017 £m	2016 £m
Auditor's remuneration	0.2	0.6
Amortisation of goodwill (see note 10)	5.7	5.8
Amortisation of intangible assets (see note 10)	11.7	10.7
Depreciation of tangible fixed assets (see note 11)	100.4	96.5
Amortisation of customer contributions (see note 11)	(4.2)	(3.7)
Loss/(gain) on disposal of fixed assets	4.9	(21.2)
Operating lease rentals	1.3	0.4

Auditor's remuneration comprises £50,000 (2016: £47,500) in respect of statutory audit services, £42,000 (2016: £41,000) in respect of other services pursuant to legislation, £105,000 (2016: £427,000) in respect of IT consultancy services, £nil (2016: £20,000) in respect of tax services, and £nil (2016: £81,000) in respect of other services.

In addition to the above services, the Company's auditor acted as auditor to the Scotia Gas Networks Pension Scheme, and fees of £10,800 (2016: £10,300) have been charged by the auditor to the Company in respect of these services.

7 Employee information and Directors' emoluments

The Company had 663 full time equivalent employees as at 31 March 2017 (2016: 729). The average monthly number of full time equivalent employees during the year was 690 (2016: 764).

The Directors received remuneration totalling £16,000 (2016: £16,000) for their services to the Company during the year. No retirement benefits are accruing in the year or in the prior year to any Directors under money purchase or defined benefit schemes, in respect of their services to the Company.

Staff costs for the Company during the year are as follows:

	2017 £m	2016 £m
Staff costs		
Wages and salaries	30.4	33.6
Social security costs	3.2	3.4
Pension costs (see note 20)	17.5	20.7
	51.1	57.7

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

8 Tax on profit on ordinary activities

a) Analysis of the tax (charge)/credit on profit on ordinary activities

	2017 £m	2016 £m
Current tax		
UK Corporation tax on profits for the year	(59.0)	(51.5)
Adjustment in respect of prior periods	7.3	0.1
Total current tax charge	(51.7)	(51.4)
Deferred tax		
Origination and reversal of timing differences	8.6	1.7
Effect of change in tax rate	31.3	64.7
Adjustments in respect of prior years	8.7	-
Total deferred tax credit	48.6	66.4
Total tax (charge)/credit on profit on ordinary activities	(3.1)	15.0

b) Factors affecting total tax (charge)/credit for the year:

	2017 £m	2016 £m
Profit on ordinary activities before tax	(243.7)	(253.4)
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 20% (2016: 20%)	(48.7)	(50.7)
Effects of:		
Expenses not deductible for tax purposes	(0.3)	(1.4)
Non-deductible goodwill	(1.1)	-
Income not taxable in determining taxable profit	-	0.1
Depreciation on non-qualifying assets	(0.3)	(0.2)
Chargeable gain on disposal	-	2.5
Effect of change in tax rate on deferred tax provision	31.3	64.7
Adjustment in respect of prior periods	16.0	-
Total tax (charge)/credit on profit on ordinary activities	(3.1)	15.0

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

8 Tax on profit on ordinary activities (continued)

The standard rate of corporation tax applied to reported profit on ordinary activities is 20% (2016: 20%)

Finance (No 2) Act 2015 introduced legislation to reduce the main rate of corporation tax from 20% to 19% from 1 April 2017 and to 18% from 1 April 2020. As these changes were substantively enacted at 31 March 2016, deferred tax at that date was calculated accordingly. Finance Bill 2016 further reduced the main rate of corporation tax from 1 April 2020 to 17%. As this change has been substantively enacted at the balance sheet date deferred tax has been calculated accordingly and this has had the effect of reducing the Company's deferred tax liability at 31 March 2017 by £30.6m. There is no expiry date on timing differences, unused tax losses or tax credits.

During the year the Company reached agreement with HMRC in respect of additional claims for capital allowances. This has resulted in an adjustment to the tax charge in respect of prior periods in the financial statements for the year ended 31 March 2017.

9 Dividends

Dividends paid amount to £135.0m (84.28p per share) for the year ended 31 March 2017 (2016: £nil). No further dividends were proposed.

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

10 Intangible fixed assets

	Goodwill £m	Software £m	Total £m
Cost			
At 31 March 2016	287.5	99.1	386.6
Additions	-	4.6	4.6
Disposals	-	-	-
At 31 March 2017	287.5	103.7	391.2
Amortisation			
At 31 March 2016	(62.5)	(52.8)	(115.3)
Charge for the year	(5.7)	(11.7)	(17.4)
Disposals	-	-	-
At 31 March 2017	(68.2)	(64.5)	(132.7)
Net book value			
At 31 March 2017	219.3	39.2	258.5
At 31 March 2016	225.0	46.3	271.3

The goodwill, which arose on the acquisitions of the business by the Company is being amortised on a straight-line basis over 50 years. This is the period over which the Directors estimate that the value of the underlying business acquired is expected to exceed the value of the underlying assets.

A review for impairment of goodwill is carried out at the end of each financial year. No impairment loss has been recorded in the current year or prior years.

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

11 Tangible fixed assets

Group	Short leasehold properties £m	Freehold Properties £m	Plant and machinery £m	Motor vehicles and office equipment £m	Total £m
Cost					
At 1 April 2016	0.5	58.3	4,551.0	71.1	4,680.9
Additions	-	6.9	240.6	5.6	253.1
Disposals	-	-	(8.9)	(6.2)	(15.1)
At 31 March 2017	0.5	65.2	4,782.7	70.5	4,918.9
Depreciation					
At 1 April 2016	(0.1)	(15.2)	(705.7)	(38.9)	(759.9)
Charge for the year	-	(3.5)	(91.1)	(5.8)	(100.4)
Disposals	-	-	3.3	6.1	9.4
At 31 March 2017	(0.1)	(18.7)	(793.5)	(38.6)	(850.9)
At 31 March 2017	0.4	46.5	3,989.2	31.9	4,068.0
At 31 March 2016	0.4	43.1	3,845.3	32.2	3,921.0

The Company has leased motor vehicles and office equipment which are considered to meet the definition of finance leases and are accounted for accordingly. The net book value of assets within motor vehicles and office equipment held under finance leases is £0.2m as at 31 March 2017 (2016: £0.6m).

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

11 Tangible fixed assets (continued)

Customer contributions

The Company has received customer contributions relating to plant and machinery. In accordance with the Company's accounting policy the assets are capitalised within fixed assets and the contributions are recognised as deferred income in the balance sheet. The connections contributions are from customers being connected to the network and replacement contributions are related to the diversion of gas mains. The deferred income is released to the profit and loss account over the estimated lives of the related assets. The amount deferred under this policy was as follows:

	Connections 2017 £m	Replacement 2017 £m	Total 2017 £m
Customer contributions brought forward	122.2	50.7	172.9
Customer contributions received in year	13.0	5.0	18.0
Amortisation in year	(3.3)	(0.9)	(4.2)
	131.9	54.8	186.7

12 Fixed asset investments

	2017 £m	2016 £m
Other investments		
Cost and net book value	0.2	0.2

Principal Company investments

The Company has investments in the following:

	Holding	%	Country of incorporation	Principal activity
Other investments:				
<i>Xoserve Limited</i>	16,050 Convertible Redeemable Ordinary A Shares at £1 each.	16.1	England & Wales	Transportation transactional services on behalf of all the major gas network transportation companies.

Xoserve Limited is 16.1% owned by the Company. During the year the Company received dividends of £nil (2016: £0.7m) during the year in relation to this investment.

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

13 Debtors

	2017 £m	2016 £m
Amounts falling due within one year		
Trade debtors	65.2	62.0
Amounts owed by Group undertakings	894.1	865.5
Prepayments and accrued income	4.8	6.0
Derivative financial assets	4.4	6.1
	968.5	939.6

Within amounts owed by Group undertakings are loans amounting to £920.1m, which incur 1.5% interest and are repayable on demand, and trading balances owed to Group companies of £38.6m. These balances are with the same party and there is a right to offset. The net amount owed by group undertakings is £881.5m, due from the Company's parent, Scotia Gas Networks Limited. Recoverability is likely to be secured through the declaration of dividends from existing distributable reserves which may, at the direction of the Company, be offset against the outstanding balance. The amount is classified as 'due within one year' in the balance sheet as the directors of the Company have the right to request repayment at any time, and the ability to pay up sufficient dividends to the parent company to permit the recovery of this balance. The remaining £12.6m is due from SGN Commercial Services Limited.

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

14 Creditors: amounts falling due within one year

	2017 £m	2016 £m
Bank loans and overdrafts	2.9	0.7
Obligations under finance leases and hire purchase contracts	0.1	1.0
Trade creditors	15.6	13.1
Other creditors	14.2	16.9
Other taxation and social security	52.5	48.1
Accrued interest	35.2	35.7
Other accruals	74.3	67.6
Deferred income	17.4	19.2
	212.2	202.3

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

15 Creditors: amounts falling due after more than one year

	2017 £m	2016 £m
Bonds:		
Fixed rate and index linked:		
£250m 2.013% index linked due 2035	231.5	227.6
£150m 2.066% index linked due 2025	208.6	205.1
£15m 2.580% index linked due 2028	18.8	18.5
£300m 5.125% fixed rate due 2018	299.6	299.3
£215m 4.875% fixed rate due 2020	214.7	214.7
£375m 4.875% fixed rate due 2029	374.0	373.9
£225m 6.38% fixed rate due 2040	223.8	223.7
£300m 4.875% fixed rate due 2023	298.4	298.1
£350m 2.5% fixed rate due 2025	346.9	346.5
	2,216.3	2,207.4
Floating rate:		
£50m floating rate note due 2018	50.0	50.0
£50m floating rate note due 2019	50.0	50.0
£125m floating rate note due 2025	125.0	125.0
£80m floating rate note due 2026	80.0	80.0
£60m floating rate loan note due 2026	60.0	-
£35m floating rate loan note due 2026	35.0	-
	400.0	305.0
Total bonds	2,616.3	2,512.4
Obligations under finance leases and hire purchase contracts	-	0.3
Derivative financial liabilities – mirror swaps	52.3	60.2
	2,668.6	2,572.9

The above borrowings are unsecured and are stated after the deduction of unamortised issue costs of £8.3m (2016: £9.5m). These costs together with the interest expense are allocated to the profit and loss account over the term of the borrowings. Interest is calculated using the effective interest rate method.

Certain interest costs in respect of index-linked bonds are not payable until the principal amount of the bond is repaid and are included within the carrying value of the borrowings stated above. The amount included in the carrying value of the borrowings at 31 March 2017 is £157.4m (2016: £149.7m).

The total revolving credit facility is £250.0m and expires in July 2019. The facility was undrawn at the year end.

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Notes to the financial statements for the year ended 31 March 2017

15 Creditors: amounts falling due after more than one year (continued)

Included within creditors falling due after more than one year are derivatives at fair value through profit and loss with a net fair value of £52.3m (2016: £60.2m), which are subject to net settlement provisions with a single counterparty. This portfolio comprises long dated pay fixed/receive floating interest rate swaps originally taken out in 2005-06 to fix the Company's interest cost over periods out to 2025, together with pay floating/receive fixed swaps taken out at a later date. The cash flow payment dates and floating leg payment terms match off, although the fixed interest payable on the offsetting swaps is in excess of the original swaps. Changes in the fair value of the portfolio on a net basis are recognised in the profit and loss account as they arise.

Maturity of borrowings:

Bonds and bank loans:

	2017 £m	2016 £m
Between one and five years	614.3	614.0
After five years	2,002.0	1,898.4
	2,616.3	2,512.4
On demand or within one year	2.9	0.7
	2,619.2	2,513.1

Finance leases:

	2017 £m	2016 £m
Between one and two years	-	0.3
On demand or within one year	0.1	1.0
	0.1	1.3

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Notes to the financial statements for the year ended 31 March 2017

16 Provisions for liabilities

Group	Environmental £m	Deferred tax £m	Other Provisions £m	Total £m
At 1 April 2016	16.9	574.8	4.6	596.3
Utilised during the year	-	-	(0.1)	(0.1)
Arising during the year	-	-	0.5	0.5
Net movement in deferred tax	-	(54.8)	-	(54.8)
Amortisation of discount	0.7	-	0.2	0.9
At 31 March 2017	17.6	520.0	5.2	542.8

Environmental

The environmental provision represents the Directors' best estimate of environmental restoration costs, where the Company has a legal obligation to restore sites at the balance sheet date. The provision has been discounted and is stated at the present value of the expenditure expected to be required to settle the obligation. The provision is expected to be utilised over the next fourteen years.

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Notes to the financial statements for the year ended 31 March 2017

16 Provisions for liabilities (continued)

Deferred tax

Deferred tax is provided as follows:

	2017 £m	2016 £m
Accelerated capital allowances	(518.5)	(568.0)
Fair value movements in financial derivatives	(1.0)	(1.5)
Other timing differences	-	0.2
Deferred tax on retirement benefit obligations	(0.5)	(5.5)
Provision for deferred tax	(520.0)	(574.8)

The movement in provision for deferred tax is as follows:

	2017 £m	2016 £m
Opening balance	(574.8)	(626.6)
Credited to profit and loss account	48.6	66.4
Movement through reserves	6.2	(14.6)
Provision for deferred tax	(520.0)	(574.8)

Deferred tax has been measured based upon corporation tax rates substantively enacted at the balance sheet date. (Information regarding rates of corporation tax can be found in note 8 to the financial statements.)

Deferred tax assets and liabilities are offset only where the Company has a legally enforceable right to do so and where the assets and liabilities relate to income taxes levied by the same taxation authority on the same taxable entity or another entity within the Company.

The Company has no unrecognised deferred tax assets or liabilities.

Other

Other provisions relate to other legal and constructive obligations held by the Company. This provision is expected to be utilised over the next thirty three years.

17 Financial Instruments

The Company's funding, liquidity and exposure to interest rate, foreign currency exchange and credit risks are managed within a framework of policies and guidelines authorised by the Board of Directors. In accordance with these policies, and in accordance with covenants set out as part of bond issuances made by the Company, financial derivatives are used to manage financial exposures.

The Company is a wholly owned subsidiary of Scotia Gas Networks Limited and accordingly is, under FRS 102 exempt from the disclosures required under sections 11 and 12 as these are detailed in the annual report of Scotia Gas Networks Limited.

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Notes to the financial statements for the year ended 31 March 2017

18 Called up share capital and reserves

At 31 March 2016 and 31 March 2017	Number	£m
Allotted, called up and fully paid		
Ordinary shares of £1 each	160,174,772	160.2

The Company's other reserves are as follows:

	Hedge reserves £m	Profit and loss account £m
At 1 April 2016	(2.3)	1,463.3
Profit for the financial year	-	240.6
Movement on cash flow hedges	0.7	-
Remeasurement of net defined benefit pension asset (see note 22)	-	(38.9)
Deferred tax movements relating to items of other comprehensive income:		
- Cash flow hedges	-	-
- Pension asset	-	6.2
Total comprehensive income	0.7	207.9
Dividends paid	-	(135.0)
At 31 March 2017	(1.6)	1,536.2

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

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Notes to the financial statements for the year ended 31 March 2017

19 Financial commitments

Capital projects contracted for by the Company but not provided in the financial information amounted to £18.9m at 31 March 2017. Within this amount £3.1m is related to intangible assets.

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

	Other		Land and buildings	
	2017 £m	2016 £m	2017 £m	2016 £m
- less than one year	1.0	0.4	0.4	0.4
- between two to five years	1.4	0.2	1.2	1.2
- after five years	-	-	11.0	11.3

20 Employee benefits

Defined contribution schemes

The Company operates a defined contribution retirement benefit schemes for all qualifying employees of the Group.

The amount recognised in the profit and loss account is as follows:

	2017 £m	2016 £m
Amount charged in respect of defined contribution schemes	2.9	2.4

Defined benefit schemes

The Company is a wholly owned subsidiary of Scotia Gas Networks which operates the Scotia Gas Networks Pension Scheme, a defined benefit scheme for a significant number of its employees of its subsidiaries who prior to 1 December 2005 were previously members of the Lattice Company Scheme and had joined prior to 31 March 2002. Employees joining the Lattice Company Scheme after 31 March 2002 were entitled to join a defined contribution scheme. Of the Group scheme, only the relevant portion relating to Southern Gas Networks Plc's members is included.

The most recent full actuarial valuations of scheme assets and the present value of the defined benefit obligation were carried out at 31 March 2015, a limited actuarial review has been carried out by Hymans Robertson LLP at 31 March 2017. The present value of the defined benefit obligation, the related current service cost and past service cost were measured using the projected unit credit method.

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

20 Employee benefits (continued)

	As at 31 March 2017	As at 31 March 2016
Key assumptions used:		
Retail price inflation	3.3% p.a.	3.1% p.a.
Consumer price inflation	2.3% p.a.	2.1% p.a.
Pension increase rate RPI	3.3% p.a.	3.1% p.a.
Salary increase rate	3.1% p.a.	2.9% p.a.
Discount rate	2.7% p.a.	3.6% p.a.

The discount rate is based on the return of high quality corporate bonds.

The assumptions relating to longevity underlying the pension liabilities reflect the characteristics of the Scheme membership ('VitaCurves') for base mortality, with an allowance for further improvements in life expectancy in line with the medium cohort adjustments subject to a 1.5% p.a. underpin in the longevity assumption. The assumed life expectations on retirement at age 65 are:

As at 31 March	2017		2016		2015	
	Male	Female	Male	Female	Male	Female
Members currently aged 65	24	25	24	25	25	25
Members currently aged 45	27	28	27	28	28	28

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

20 Employee benefits (continued)

The analysis of scheme assets and the amount included in the balance sheet arising from the Company's obligations in respect of its defined benefit retirement benefit schemes at the balance sheet date is as follows:

As at 31 March

	2017 Fair Value £m	2016 Fair Value £m
Equities	181.9	145.0
Government bonds ²	177.4	208.3
Corporate bonds	225.3	234.0
Property	33.0	33.0
Cash	21.2	5.0
Insurance contracts	54.5	-
Total market value of assets	693.3	625.3
Actuarial value of liabilities	(690.4)	(594.4)
Net pension asset	2.9	30.9

To reduce the risk of volatility in the Scheme's funding level, a liability driven investment (LDI) strategy forms part of the assets employed within the investment strategy of the Scheme. The LDI strategy provides circa 41% interest rate protection and circa 55% inflation protection as at 31 March 2017 with respect to the pension scheme liabilities of circa £1.56bn (valued using a UK government bond yield curve). The Scheme assets which provide this interest rate and inflation protection are managed by BlackRock and Goldman Sachs and include a variety of instruments e.g. UK government bonds (gilts), interest rate swaps, inflation swaps, gilt repos and corporate bonds. Over the year to 31 March 2017, the Scheme also implemented a pensioner buy in and this also contributes to the total interest rate and protection ratios referred to above.

² Including LDI repurchase agreement liabilities.

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Notes to the financial statements for the year ended 31 March 2017

20 Employee benefits (continued)

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

	2017 £m	2016 £m
Opening defined benefit obligation	(594.4)	(644.5)
Current service cost	(14.8)	(18.1)
Administration costs	(0.3)	(0.3)
Interest cost	(20.4)	(20.7)
Contributions from scheme participants	-	(0.8)
Actuarial (losses)/gains	(157.5)	74.6
Benefits paid	97.0	15.4
Closing defined benefit obligation	(690.4)	(594.4)

Movement in the fair value of scheme assets were as follows:

	2017 £m	2016 £m
Opening fair value of scheme assets	625.3	608.8
Interest income on scheme assets	22.0	20.0
Contributions from scheme participants	-	0.8
Contributions from Southern Gas Networks Plc	24.4	25.0
Remeasurement of scheme assets	118.6	(13.9)
Benefits paid	(97.0)	(15.4)
Closing fair value of scheme assets	693.3	625.3

The actual gain on scheme assets was £140.6m (2016: gain of £6.1m).

Southern Gas Networks plc

Notes to the financial statements for the year ended 31 March 2017

20 Employee benefits (continued)

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

	2017 £m	2016 £m
Current service cost	(14.8)	(18.1)
Administration costs	(0.3)	(0.3)
Total charged to operating profit:	(15.1)	(18.4)
Expected return on scheme assets	22.0	20.0
Interest charge on scheme liabilities	(20.4)	(20.7)
Net interest credit/(cost)	1.6	(0.7)
Net charge to the profit and loss account	(13.5)	(19.1)

	2017 £m	2016 £m
Actuarial gain/(loss) on scheme assets	118.6	(13.9)
Actuarial (loss)/gain on scheme obligations	(157.5)	74.6
Remeasurement (loss)/gain in scheme	(38.9)	60.7
(Loss)/gain recognised in other comprehensive income	(38.9)	60.7

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Notes to the financial statements for the year ended 31 March 2017

21 Parent company and related party transactions

The Company is a wholly owned subsidiary of Scotia Gas Networks Limited, a Company registered in England and Wales.

Scotia Gas Networks Limited is owned by a consortium consisting of SSE plc (33%), Borealis Infrastructure Europe (UK) Limited (25%) which is indirectly wholly owned by OMERS Administration Corporation, OTPPB Investments (UK) Limited (25%), which is owned by Ontario Teachers' Pension Plan Board, and Blue Spyder B 2016 Limited (17%), which is owned by Abu Dhabi Investment Authority. It is the opinion of the Directors that the parent Company, Scotia Gas Networks Limited, has no single controlling party as that Company is controlled jointly by the consortium.

In accordance with FRS102 the Company is exempt from disclosing transactions with subsidiaries that are wholly-owned by the group.

Transactions with shareholders

Amounts owed to shareholders and loans from shareholders are set out below:

	2017 £m	2016 £m
Other amounts owed to shareholders:		
SSE plc	8.7	9.9

The amounts owed to shareholders mainly comprise amounts payable in respect of a managed service agreement for corporate services and material purchases.

The following transactions took place during the year between the Company and the SSE plc group of companies ("SSE").

	2017 £m	2016 £m
Sales of goods and services	102.7	105.0
Purchase of goods and services	(31.3)	(31.8)

Sales of goods and services to SSE primarily represent gas transportation services. At 31 March 2017 an amount of £0.2m was owed by SSE in relation to these services and is included within trade debtors.

SSE provides services to the Company in the form of a management services agreement for corporate services. The Company also purchases certain items such as consumables stock, shrinkage gas and public liability insurance from SSE.

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Notes to the financial statements for the year ended 31 March 2017

22 Subsequent events

There are no subsequent events to report.