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Station Approach
Horley
Surrey
RH6 9HJ

Utility Regulator
Queens House
14 Queen Street
Belfast BT1 6ED

6th May 2014

Subject: Supporting Narrative to SGN Annual Accounts

The purpose of this letter is to explain the negative net asset position in the Scotia Gas Networks Limited group accounts, and to set out how this relates to the financial strength of the group.

The primary reason for the negative balance sheet in the consolidated UK GAAP accounts at 31 March 2013 is that under UK GAAP, replacement expenditure ("repex") is expensed in the profit and loss account. However, repex is capitalised under IFRS and is likely to be capitalised under the new UK GAAP framework ("FRS 102") which is applicable for the first time for the 31 March 2016 year end. Under IFRS, the consolidated net asset position is over £2bn higher than under UK GAAP, the difference being mainly the net book value of historical repex. The treatment of this expenditure as capital reflects the nature of it more appropriately because repex generates economic benefit over a number of years as it is added to our Regulated Asset Value ("RAV"). Indeed, all three of the credit rating agencies make a repex adjustment to increase the profit in our UK GAAP statutory accounts in order to arrive at the earnings metrics which they use to assess the company. They do this so that they reflect the true earning capacity and financial strength of the company.

The RAV has increased significantly over time, and it can be seen from the audited Scotia Gas Networks Limited group accounts for the year ended 31 March 2012, that in the holding company the investment in the two distribution networks was revalued upwards by £1bn in June 2011 based on a third party valuation. This makes the parent company only balance sheet a positive £1.1bn, but note that the investment in the networks is eliminated on consolidation, and the fixed assets in the individual networks are still based on historical cost. Therefore the consolidated group accounts do not reflect the increase based on the updated RAV. However, it is evidence of the increased value of the networks based on a reasonably recent RAV based valuation. It is more appropriate to consider the financial strength of the company based on a RAV based valuation of the assets, rather than a historical cost basis.

We hope this describes why the nuance of UK GAAP accounting treatment of repex results in a negative net asset position which is not reflective of the financial strength of the group, and why a RAV based valuation of assets is more appropriate. We would be happy to answer any further specific questions you might have in relation to this, or to provide any further supporting evidence you require

Yours sincerely

C.J. Brook

Chris Brook
Chief Financial Officer

Scotia
Gas Networks

Annual Report and Accounts 2013

Contents

Front cover: Maintenance craftsmen Ryan Higgins and Mark Hamill carrying out six monthly maintenance on the high pressure regulator system feeding the City of Glasgow.

This page: Provan is the largest operational gas site in Scotland. It houses the primary gas feeds to the City of Glasgow and is the base for our maintenance operations in Scotland and our plant maintenance repair workshop.

Financial and operational highlights

98.4%

Gas escapes attendance within an hour in 2012/13

£398m

Network investment in 2012/13

Poundbury

Biogas plant operational

£4.8bn

Regulated Asset Value at 31 March 2013

Innovation

EIC winner 2013

60

Community Action Programme completed schemes

Chairman's introduction

Last year was a very challenging year for our company, with a continuing uncertain economic environment and a critical negotiation with Ofgem to finalise the 2013/21 gas distribution price control, with its new regulatory arrangements. I am delighted to report, however, that Scotia Gas Networks has emerged in good shape and is well positioned to address the tough demands this price control presents over the course of the next eight years.

During 2012/13 our turnover increased to £965 million and in addition we invested a further £398 million in our gas infrastructure and groundbreaking innovations across our regions.

In my statement last year I set out our three key objectives. We wanted an acceptable outcome from the regulatory price review, to continue our track record of delivering high standards of safety and customer service, and finally to deliver on our projects to green the gas.

I will cover the price control in a moment; however I am delighted to report we have performed very well on safety and customer service throughout the year in some challenging circumstances. This is largely due to the commitment and professionalism of our people across our business. On greening the gas I am pleased to report we have achieved our aims through our award-winning biomethane project in Poundbury, with it becoming the UK's first commercial scale plant to come online. The Poundbury plant was opened by His Royal Highness The Prince of Wales in November last year and we are now actively pursuing more and larger scale projects.

Turning to the price control, our Board accepted Ofgem's final proposals for the 2013/21 gas distribution price control after due consideration. Delivery of the Ofgem targets will be a tough challenge but one I believe we are well placed to achieve. Our priority remains to deliver a safe, reliable and sustainable gas network in a low carbon future. This is despite Ofgem reducing by 10% our business plan proposal for the total amount we are allowed to spend to operate and upgrade our network to £511 million a year. Included in this total is a reduction for our gas mains replacement programme, which has been a major contributor to gas safety over the past decade.

Our objectives

Our priority remains to deliver a safe, reliable and sustainable gas network.

Over the course of the next eight years we will replace around 8,400km of old metallic gas mains with new modern plastic pipe.

We were pleased to see built-in to the price control, incentives to earn additional income for good performance. We are determined to ensure we exceed all our targets in these areas to maximise our income.

I am confident we have the people and the management to succeed in the new regulatory world. With the full backing of our board, we will continue to develop our company into one we can all be proud of and which will be a leader in the UK's gas industry.

Gregor Alexander
Chairman
25 July 2013

Awards

Being recognised for the work we do and the professionalism and contributions of our people is something we believe adds value all round. It engenders pride among our employees, knowing their hard work has been recognised, but also it provides our company with a strong standing among our peers, knowing we lead the way in a number of important areas.

Whether it's gas industry recognition, safety or innovation, they all matter and throughout the course of 2012 and at the start of 2013 we have been recognised in a number of different areas.

At the UK Energy Innovation Awards this year, we were honoured with the top award in the Environmental Impact category. The joint win with our partner JV Energen recognised the significance of our biomethane initiative at Poundbury, which is the UK's first commercial biomethane to grid project. It was a significant achievement having created a meaningful and lasting legacy on the energy network.

In December 2012 we won our first Utility Industry Achievement Award in the Capital Project Management category. This recognised the engineering excellence and community engagement efforts of our record-breaking undersea pipeline project to the Isle of Wight.

After a double success in 2012, we again received two more prestigious EUA/IGEM Gas Industry awards in 2013. Glenn Norman, our Head of Operations (Southern) was recognised as the industry's Manager of the Year and our company won the industry's overall energy efficiency award, recognising the significant progress we have made in this important area of our business.

Also on the environmental side in 2012 we won our second Green Apple Environmental Award recognising our internal environmental programme.

We were also very proud when our senior manager Chris Bielby was awarded an MBE, recognising his services to Gas Safety across the industry.

01 His Royal Highness the Prince of Wales opens our Poundbury plant.

02 Gas industry double award winners.

Our business

Regulated by Ofgem, our company owns and operates gas transportation and distribution networks in Scotland and the south and south-east of England. Our primary function is to provide a safe and secure supply of gas to our 5.8 million customers. This service includes the provision of a highly professional and robust emergency service to keep our customers and the general public safe, responding quickly and efficiently to calls.

Focused on our customers

Our principal objectives are:

- To deliver natural gas safely, reliably and efficiently across the gas distribution networks;
- To provide the highest standard of service to our customers;
- To deliver value to our shareholders.

Our overall financial objective is:

- To focus on operational efficiency and the efficient delivery of our capital and replacement expenditure programmes. Financial objectives are set to ensure regulatory targets are achieved or outperformed.

Customer focus

We were the first gas network company to publish a Customer Charter, which sets out clearly and concisely what our 'customer promises' are. This is available on our website.

Our operations throughout the UK

Our Scotland network distributes gas across all of Scotland to 75% of households, including remote areas via the Scottish Independent Undertakings (SIU) at Stornoway, Wick, Thurso, Oban and Campbeltown.

Our Southern 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, distributing gas to around 90% of households.

Our values underpin everything we do

Safety

We all take responsibility for our own safety and for the safety of others

Performance

We strive for commercial success through efficiency, continuous improvement and innovation

People

We work and develop together with honest communication and respect

Customers

We listen to and understand our customers' needs, deliver a quality service and keep our promises

Our world

We show through our actions that we care about the world and the communities around us

The scale of our business

Our Company owns and operates the regulated gas transportation networks in Scotland and the south and south-east of England which makes up two of eight regional gas distribution networks in the United Kingdom.

Gas networks' regulation

All gas network companies are the subject of economic regulation through Price Control Reviews set by industry regulator Ofgem. The five year Price Control which ended on 31 March 2013 was applicable for the period covered by this Annual Report, and is described below. Further details on the next 8 year RIIO-GD1 Price Control are in the Chief Executive Officer's review.

The index-linked revenue earned comes from charges levied on network users, to cover costs and earn a return on regulated assets. Ofgem also places incentives on companies to be more efficient and innovative and to deliver an enhanced quality of service.

Ofgem also sets the framework for capital investment the companies make in maintaining and upgrading the gas networks. The networks each have a Regulator Asset Value (RAV) which represents:

- The price paid for them when they were privatised;
- Plus allowed capital expenditure;
- Less annual depreciation.

The RAV is indexed to the Retail Price Index.

Our structure

Scotia Gas Networks

The Company is owned by three shareholders – SSE plc (50%), Borealis Infrastructure Europe (UK) Limited (25%), which is indirectly wholly owned by OMERS Administration Corporation and OTPPB Investments (U.K.) Limited (25%), which is owned by Ontario Teachers' Pension Plan Board.

Our vision

To be the leading operator of gas networks in the UK.

5.8 million

5.8 million domestic, commercial and industrial customers in the Southern region and throughout Scotland.

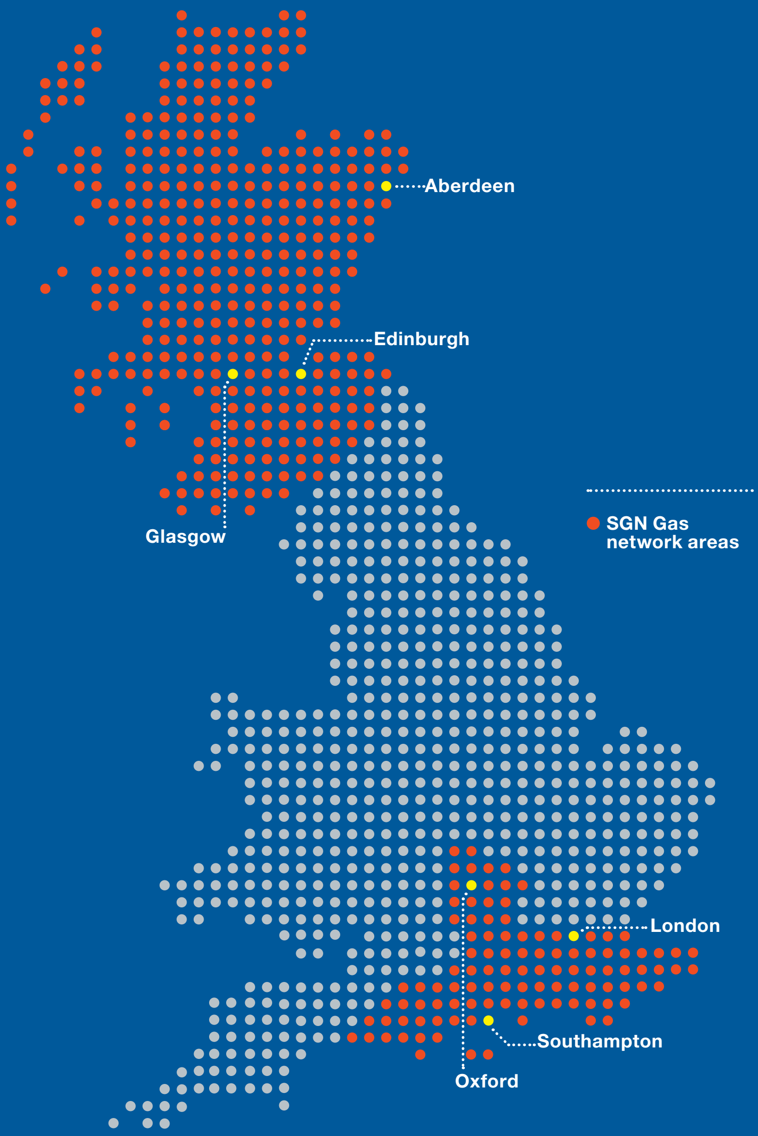
74,000km

74,000km of gas mains delivering natural gas throughout our regions.

3,676

We totalled 3,676 full-time equivalent employees as at 31 March 2013 (2012: 3,787).

Our operations throughout the UK



Our Structure

Scotia Gas Networks

- Scotland Gas Networks
- SGN Commercial Services
- SGN Contracting
- SGN Connections
- Southern Gas Networks

Our people

Our people are the lifeblood of our company, which is something we recognise though one of our core company values. Our ‘people’ value says ‘we will work and develop together with honest communication and respect’. To achieve this we maintain and develop a strong team of people who have professionalism and a technical knowledge required of participants in the gas industry and the generic skills to enable our company to continue to be successful in everything we do.

Our aim

To work together as a team and respond efficiently in an emergency.

01

01 **Engineers speaking with a customer in Tillicoultry.**

02 **Our Apprentices are the future for our company.**

03 **Getting involved in a community project.**

“Your engineers have done a terrific job they are brilliant.”

“Excellent use of Twitter – other companies could well learn from this.”

Team working in an emergency

Whenever there is a major emergency situation, as we experienced twice during 2012, our people always come to the fore, demonstrating their professionalism and dedication. In our day-to-day activities there exists a strong sense of teamwork that is particularly prevalent when we have customers without gas or there are vulnerable people at risk.

Our apprentices

Last autumn 45 young people joined as trainees and with the help of our training team went on to attain gas competency qualifications. Of these, 42 have been selected to move on to a three-year apprenticeship, which will provide them a wide selection of skills covering many of our engineering activities. These are our engineers, team leaders and managers of the future and encouraging them at this early stage in their careers is something we take pride in doing.

Working in our communities

We encourage all our people to take advantage of the extra day off they are given to get involved in our Community Action Programme. Across the company over 60 schemes helping communities and charities were worked on last year involving many of our people. These schemes are very much appreciated by the organisations we help and many letters of thanks are received. The work also provides an excellent opportunity for team building among our people and the direct feedback from them is always very positive.

Engaging with our people

The new price control for 2013 to 2021 was a tough settlement and consequently our people needed information from the top as to how it would affect our company and their working lives. Recognising communication was key to this process and, as well as issuing a series of RIIO fact sheets to all our people, the leadership team undertook a tour of our operational locations. 24 workshops known as ‘Let’s Chat’ sessions, involving over 1,200 of our people were held. This was a significant investment in time and money but the need for everyone to have an understanding of the new price control and the company’s position is an essential element in bringing about the flexibility and commitment we need to see us successfully through. Communicating with our people in an approachable, honest and open way is something we will continue to do in all aspects of our business.

Recognition of excellence

Last year we introduced for the first time an internal awards ceremony called our ‘outstanding people awards’. Over 350 nominations from around our company were received for the 14 categories of excellence and the eventual winners were very deserving, having demonstrated a care and determination to do their jobs, or look after our customers in an exemplary fashion.

Chief Executive Officer's review

Formed in June 2005 our business has grown and developed across all areas, with safety and operational excellence firmly at the centre of everything we do. Our people remain fundamental to the success of our company, and their flexibility, professionalism and ability to embrace innovations puts us in a very commanding position for the future.

Our primary function will always be to provide our 5.8 million customers with a safe and secure gas supply. In addition we offer varied careers and employment for our 3,676 people, with progressive apprentice schemes ensuring we can introduce the next generation of gas engineers and managers to our ranks.

Regulation and network investment

Price control 2008 to 2013 – achieving investment and growth

The five-year gas distribution price control, which began in April 2008 and drew to a close this year, provided us the opportunity to significantly increase investment in our gas distribution networks, meeting the targets set for the period. As a result our total regulatory asset value (RAV) reached £4.78bn.

During the last year of this price control, we invested £398m in capital expenditure and gas mains and services replacement projects, compared with £404m in the previous year. The majority of our replacement expenditure was incurred under the 30:30 mains replacement programme, which started in 2002. This requires all iron gas mains within 30 metres of homes and premises to be replaced over a 30-year period.

During 2012/13, we replaced 1,124km of metallic gas mains with modern polyethylene pipes. Capital investment projects included the development of a new UK-leading biogas plant at Poundbury in Dorset. We demonstrated our commitment to making new gas connections to existing homes as affordable as possible, with our Assisted Connections scheme. Last year we connected 6,714 homes to our networks.

Major investment projects – a future for gas

The challenge to the UK gas industry going forward is to ensure we provide secure and sustainable sources of gas for generations to come, working together with wider industry and government to achieve this.

Poundbury

Recognising the potential of unconventional sources of gas, we have been innovating and developing in the field of green gas for around four years. This development work continued this year reaching the next stage of our journey in November 2012 with our Poundbury biomethane plant starting production of and injecting biogas into the local distribution network.

This award-winning plant at Rainbarrow Farm is a joint-venture with JV Energen, and saw us invest over £2 million in creating the UK's first commercial scale biomethane plant.

Poundbury is the urban extension of the Dorset county town of Dorchester, part of the Duchy of Cornwall estate. The project can be broken down into two stages. JV Energen is responsible for the production of biogas and we are responsible for cleaning it and injecting it into the local gas distribution network.

The plant was opened by His Royal Highness the Prince of Wales in November 2012 and has since been the recipient of a prestigious award from the Energy Innovation Centre (EIC) taking the honours in the environmental impact category.

Crouchland

In March 2013, just three months after the opening of Poundbury we signed contracts for a further biogas plant. This 20-year deal is our latest greening the gas initiative and is heralded as being even more pioneering than Poundbury.

Our partner is Crouchland Biogas Ltd and the project has the potential to be four times the size of Poundbury. Gas produced from this facility, which is scheduled to come on-line in the next 12 months, will be transported to our new gas injection facility at Portsdown Hill near Portsmouth. At this point it will be blended with mains gas and fed directly into our local gas distribution network.

The five-year gas distribution price control, which began in April 2008 and drew to a close this year, provided us the opportunity to significantly increase investment in our gas distribution networks, meeting the targets set for the period.

The pioneering element of our Crouchland project is that it removes the need to add propane during the process, providing significant environmental and cost benefits. It is another example of how our green gas agenda is also assisting the UK government with its carbon reduction targets.

Provan

We operate five Scottish Independent Undertakings (SIUs) in Scotland, at Oban, Campbeltown, Wick, Thurso and off the mainland coast at Stornoway. After the closure of the National Grid LNG plant in Glenmavis, we built new gas storage containers at our existing Provan site situated on the east side of Glasgow. We have trailer-mounted mobile shipping containers which allow us to continue to supply our 8,500 customers in the SIUs, as we are obliged to do under our licence condition.

The current arrangement is not long term and we continue to work with the Scottish Government and other stakeholders to seek and implement an enduring solution.

1,124km

Metallic pipe replaced in the year.

The SGN business model

Our business model is based on a local depot organisation. This ensures we are as close to the point of service as possible. We have a policy to in-source where practicable. Full control of our systems and managing down reliance on third party contracts is also a key to our success.

1 Depot network
- Better issue resolution
- Better use of resources
- Local interaction with customers

2 Insourcing contractors
- Operational control
- Cost reduction

3 Managed service agreements
- Discounts from volume purchasing
- Common stock lines

4 Systems approach
- Full control of gas pipeline assets

Chief Executive Officer's review continued

Safety

Safety is and always will be our primary company value. Our engagement on issues such as public safety around our roadworks, emergency service provision, gas pipe risk and carbon monoxide awareness among others, is always proactive and helps to inform our decisions about mitigating key safety risks for our people, our contractors and in the communities in which we work.

Our whole approach to safety risk management is designed to engage people at every level in a positive and productive way, encouraging ownership, authority and accountability. This helps us keep the public, our people, our assets and the environment safe and secure.

Injury performance

We strive to ensure a safe workplace for our workforce, the target being the elimination of all workplace injuries. This year our lost time injury rate was 0.08 per 100,000 hours worked (0.04 2011/12).

Safety initiatives

We are committed to implementing new initiatives to promote gas safety in the communities in which we operate, as well as protecting the safety of our own people. We do this in a number of key ways:

- Promoting gas and carbon monoxide (CO) safety messages to children and vulnerable members of society;
- Improving street works safety, resulting in reduced risk of injuries to members of the public;
- Improving access to key safety information for anyone working in the vicinity of our assets; and
- A sustained campaign to reduce the risk to our own people from buried electricity cables.

New safety management framework

One of our new initiatives involved looking inward to ensure the way we do things reduces the risk of incidents. Fundamental to achieving this is the quality and usability of our policies and procedures.

Through engagement and feedback from our internal stakeholders, the need to further improve our safety management system was identified. Our key objective was for our large suite of technical and safety documents to be more reflective of our safety ethos and more clear, usable and accessible.

We developed a new safety management framework (SMF) for all our activities. The SMF is now at the core of our safety management system and we have introduced twelve new goal setting standards in terms of desired technical and safety outputs.

Business continuity management

We have spent two years developing and implementing a robust Business Continuity Management system which means we have plans in place to mitigate the impact of continuity threats to our business critical processes.

Our commitment to this area was endorsed through the British Standard for Business Continuity Management, BS25999 accreditation. As one of the first utility companies to achieve this standard, we believe it gives all our stakeholders confidence that we can continue to function in the event of any business disruption.

Board responsibility

Our Board has a safety, health and environmental advisory committee responsible for monitoring our health and safety performance, ensuring adherence to our health and safety policy and providing the Board with reports on any key issues. Further details of the committee are set out on page 29 in our corporate governance statements.

Customer service

Customer service initiatives

Feedback from our customers comes through enquiries, surveys and complaints. They have told us they want to be better informed and looked after when we carry out work that affects them. During the year we commissioned a market research company to identify the most important elements of our service to our customers. This research identified any differences within demographic categories and benchmarking with other utilities and service sector businesses, identified that our customers quite rightly expect high levels of service from all sectors.

One of our new initiatives involved looking inward to ensure the way we do things reduces the risk of incidents. Fundamental to achieving this is the quality and usability of our policies and procedures.

Time saving

This technique reduces our job time from three days to just several hours.

In addition, through focus groups and local forums, we asked for views on the service we provide and what could be improved. We recognised that our skilled workforce displays a pride and passion in their work and that we needed to tap into this and spread it throughout our organisation. The outcome was the rollout of our PRIDE programme, developed for our customer-facing workforce to embed the pride and passion philosophy associated with genuinely wanting to look after our customers and being proud of the difference we make.

Key elements of the programme include effective communication, keeping our Customer Charter promises and learning to positively deal with difficult situations.

Our initiatives have achieved real success. Since 2009/10, complaints have been reduced by 42%, compensation claims are down by 35%, customer enquiries are 30% lower and thank you correspondence is received from our customers every day.

Olympic delivery

Carefully planning and carrying out our emergency, replacement and connections work is always important but last summer saw parts of our network come under real focus as the 2012 London Olympics and Paralympics took place. We were part of a group called Clearway that worked together from 2008 to ensure the success of the Games, with the main aim of this working group being to ensure infrastructure was maintained across a number of key roads including the ORN (Olympic Route Network).

6,714

Fuel poor connections through our assisted connections programme.

Case Study
Innovation – core and vacuum excavation

Innovation is what can set us apart from others and our new core and vacuum equipment and technique is revolutionising the way we work, greatly reducing the time to repair a gas escape.

Instead of digging a large hole we use a cutter to remove a 24” or 12” core through the road surface. We then use an ‘air pick’ and vacuum excavator to loosen and remove the remaining spoil. The removed core and spoil are stored for re-use, reducing impact on the environment.

We then backfill the excavation using all the material we removed earlier. A special compaction monitor is placed at the bottom of the excavation to ensure our reinstatement meets required standards. Finally a bonding agent is used to reset the original core back into position. This sets in 45-60 minutes and the road can be fully reopened.

Used in conjunction with a new piece of equipment called a magnetometer, we are often now able to pinpoint the location of the leaking joint on the gas main to within 12 to 24 inches.

01 Core and vac in operation on a South London street.

Chief Executive Officer's review continued

The Clearway group comprised Transport for London (TfL), London Boroughs and utilities. There was also attendance by Ofgem, the HSE and a number of government bodies such as the ODA (Olympic Delivery Authority) and LOCOG (London Organising Committee for the Olympic Games).

Regular meetings were held to ensure all stakeholders were up-to-date with the various restrictions being imposed at venues such as Greenwich Park and the Weymouth sailing venue. Customer-related activity included sending our gas connections customers bespoke flyers advising them of work restrictions in place.

Internally we held numerous teleconferences with our employees to keep them fully informed.

There were a number of small gas incidents during the Games themselves within venues and adjacent roads that were all dealt with effectively and professionally by our teams without disruption.

Innovation

Core and vac initiative

Our innovation and operations teams have together developed a unique technique with state-of-the-art equipment for reducing the time taken to repair gas escapes. Our core and vac initiative sees one machine and a team of two operational engineers complete a repair job in hours, which otherwise would have taken days.

Transport for London (TfL) had previously stated our performance was 'below standard' in relation to the duration of and disruption caused by our repair works. We therefore actively engaged with TfL and requested their support and feedback on the implementation of our core and vac initiative within London.

Following this, in December 2012, we demonstrated to TfL streetworks managers as well as the Deputy Mayor of London the initiative in use on site. This pilot project in London was followed by a further trial in Glasgow. Responses to date have been positive and we are now looking to engage with other local authorities about the benefits of our core and vac technique.

Other innovations being considered include robot technology from the USA called CISBOT (Cast Iron Sealing roBOT). This is a system which makes repairs to joints on existing cast iron gas mains from the inside. This is proven technology in the USA and something we will be trialling in our own networks during the coming months.

Environment

During the past year we were awarded our second Green Apple Environment Award by The Green Organisation, an independent group dedicated to recognising and promoting environmental best practice. This was presented to us at a ceremony at the House of Commons.

We won the accolade for our 505 campaign, our five internal environmental objectives set over a period of five years.

These objectives were:

- Reduce our natural gas emissions;
- Reduce our carbon emissions;
- Reduce our impact on landfill;
- Increase our energy efficiency; and
- Reduce any wastage of materials.

The Green Apple Awards acknowledge Britain's greenest companies, councils and communities across all industry sectors. Our win demonstrates our commitment to making our environmental programme successful.

We also received recognition through the Gas Industry EUA/IGEM awards by winning its 2013 Energy Efficiency Award. This award recognised our challenging targets and objectives to improve our performance in all aspects of environmental management. One area is energy efficiency, which we extended to encompass effective waste management and a focus on reduced resource consumption across our networks.

In the last three years we have successfully embedded a new approach to waste management across our networks. The benefits of our waste reduction strategy include a reduction in waste handling costs of approximately 80% and recycling 98% of the waste collected.

The Green Apple Awards acknowledge Britain's greenest companies, councils and communities across all industry sectors. Our win demonstrates our commitment to making our environmental programme successful.

£16.5m spend

on large maintenance projects, keeping the gas flowing for our customers.

Excavated material

Our improvement in waste management also includes reducing the amount of material sent to landfill to less than 3% of the original amount excavated, as the vast majority of our spoil is now reused or recycled. Over the last five years our application of the 'waste hierarchy' to encourage prevention, re-use and recycling in preference to landfill disposal has resulted in the diversion of over two million tonnes of our waste away from landfill.

A key area benefiting from our focus on re-use of resources is our PE (yellow plastic gas pipe) consumption. We have achieved a 38% reduction in PE wastage by facilitating easier reuse of pipe in our depots and establishing a 'PE trade' facility on our intranet, a system which enables materials to be traded between depots rather than ordering new items.

Incident management

At the end of last year our ability to respond to emergency situations was fully tested as we experienced two major losses of gas supply in Scotland in November and in Kent in December with the prospect of over 7,000 gas customers being without their essential energy source in the height of winter.

570

Staff involved in a CAP scheme in 2012/13.

Case Study
Maintaining our assets

To ensure we deliver gas safely and securely to our 5.8 million customers, maintaining our existing assets is a key part of our operations.

Across our Southern and Scotland network areas we operate and maintain 30 gas off-takes from the National Transmission system as well as looking after around 3,100km of high pressure pipeline. In order to transport gas efficiently and safely across our network from transmission pipeline into the home, we maintain and operate 313 pressure reduction stations. We also maintain 7,284 district governors as well as 31,290 individual service governors.

We delivered a number of large maintenance projects during 2012/13, 111 in Scotland and over 200 in Southern, with a combined spend of £16.5m. Site monitoring and control are important parts of our maintenance programmes, which include monthly and quarterly site inspections and annual technical assessments.

By the end of the current price control in 2021, we envisage that half our remaining 110 gas holders will have been removed.

01 From left: Brian Dickson, Maintenance Manager, Billy Brown, Maintenance Craftsperson and Colin Campbell, Team Manager.

Chief Executive Officer's review continued

Clackmannanshire incident

On 27 November, a medium pressure gas mains situated on farmland in our Scotland network was damaged. The challenge ahead involved restoring gas supplies to some 3,500 homes and businesses in Dollar, Coalsnaughton and Tillicoultry in the county of Clackmannanshire. It was thanks to a quick engineering response from our teams that the medium pressure network was quickly reconfigured avoiding the loss of gas suppliers to a further 2,000 homes in nearby Alva.

Following a massive effort from across our Scotland operations teams, gas was restored to all our customers by 30 November, just three days after the initial damage was incurred. This was a tremendous effort from not only our own people, but by working closely with many other agencies and volunteer organisations, the task was made a lot easier. At the conclusion of the incident the Scottish Government's Energy Minister contacted us to express his appreciation of our 'fantastic response'. We also received many thank you letters from customers equally delighted at the speed of our response and the level of customer care demonstrated.

Kent incident

A month later, on 30 December a burst water main bored a hole in the side of our gas main allowing some 125,000 litres of water into the pipe unabated. This in turn caused a loss of gas supplies to 1,700 customers in the Orpington area.

The damage occurred the night before New Year's Eve and it soon became apparent full gas restoration would need to go on over the festive period, with the need for our teams to work through the Bank Holiday. It is testament to the dedication of many of our people that they gave up personal commitments to ensure gas was restored as quickly as possible to those affected by the loss of mains gas for heating and cooking. A massive team effort ensued with the end result being all supplies being restored within a few days. As with the Scotland incident, many letters of thanks and appreciation were received from local people and residents' associations.

Stakeholder engagement and social responsibility

Our business affects the lives of millions of people in diverse geographical areas and we provide them all an essential service, meaning stakeholder engagement must be central to our business.

Stakeholder engagement informs our purpose, our vision, and our strategic objectives. It is embedded in our organisation from our processes and procedures to our culture and the way we behave. It is fundamental to ensuring the efficient use of our assets and the transition to a low carbon economy, as we described in our business plan submitted to Ofgem.

Community support

We believe we have a strong role to play in the communities in which we live and operate.

Community Action Programme

We allocate each of our employees an additional day of paid leave every year to get together in groups to take part in our self-styled Community Action Programme (CAP). Not only does this promote team working but it allows many varied and deserving good causes to have a team of our employees helping them out.

Other community support

During the year we supported a campaign aimed at helping older and vulnerable members of the community stay warm in the winter. The initiative offers free 'home safety' visits providing advice, support and free carbon monoxide (CO) detectors, support to switch to cheaper energy tariffs, grant support to cope with winter fuel emergencies, debt advice tailored to individual circumstances and assessment for mains gas connections.

For this campaign, we provided over 1,500 carbon monoxide detectors which are being fitted throughout Hampshire by the Blue Lamp Trust, a charity which promotes and enhances community safety in the county. Alongside this, we also organised for our engineers in Hampshire to give out referral cards to those customers who may potentially be eligible for the scheme.

We are currently undergoing a fundamental change programme within our company to meet the tough challenges set by this new price control. As you would expect, our preparations include retaining a strong focus on safety and cost efficiency.

Fuel poverty

Our responsibility to facilitate network extensions and fuel poor connections has provided a great opportunity to work alongside a broad range of stakeholders.

Working closely with registered social landlords and third sector organisations, we have to date completed some 17,000 fuel poor connections and the new price control period will see us continue this work on a significant scale.

The new RIIO price control 2013 to 2021

The new price control period which commenced in April 2013 (RIIO-GD1) covers an eight year period up to March 2021. We accepted the final proposals published by Ofgem in December 2012, believing that the level of capital and operational expenditure allowed will be enough to maintain safe and reliable networks, serve our 5.8m customers, and secure a fair return for doing so.

We are currently undergoing a fundamental change programme within our company to meet the tough challenges set by this new price control. As you would expect, our preparations include retaining a strong focus on safety and cost efficiency. Additionally, a key area of attention is innovation, with specific allowances available each year.

During the next eight years we have committed to delivering a wide range of outputs which include:

- 40% reduction in risk of incident;
- 20% reduction in leakage emissions;
- Tough targets on customer service – depending on our performance, we could gain or lose £8 million a year;
- 20,000 fuel poor connections;
- Improving the general health of our assets;
- Maintaining our 97% emergency standard as well as a new way of measuring residual risk from gas escapes.

If we meet the outputs Ofgem has set but do this for less money than Ofgem has allowed us through specific incentive schemes, we will be able to share the savings with our customers. We have been allowed by Ofgem over £4.6bn (at 2012/13 prices) of cost allowances to deliver these outputs efficiently.

Our investment programme is key to this delivery and, within the overall cost allowances, Ofgem has allowed around £2.8bn over the period to cover new investment and to manage the risks relating to our existing assets. This investment will allow us to:

- Deliver a safe and reliable network for our customers;
- Minimise the impact on the environment and minimise disruption for customers and communities; and
- Implement new customer-driven initiatives to help reduce fuel poverty and increase awareness of the dangers of carbon monoxide.

I am confident that we are well prepared for the future under the new regulatory regime, and that we will continue to build on our successful track record.

John Morea
Chief Executive Officer
25 July 2013

£2.8bn

Ofgem allowance for investment.

Key performance indicators

We measure how successful we are in achieving our objectives through the use of quantitative assessments and, where these are less relevant, through the use of qualitative assessments. Our principal key performance indicators (KPIs), which are used to assess whether principal operating objectives have been achieved are set out below:

Financial

EBITDA

£348.5m

2013	£348.5m
2012	£329.5m
2011	£227.5m
2010	£240.7m

Earnings before interest, tax, depreciation and goodwill amortisation ('EBITDA') is a non-statutory measure and is calculated by adding back goodwill amortisation and depreciation to operating profit.

Adjusted EBITDA

£601.5m

2013	£601.5m
2012	£590.1m
2011	£483.5m
2010	£485.4m

EBITDA excluding replacement expenditure ('Adjusted EBITDA') is calculated by adding back goodwill amortisation, depreciation and 100% of replacement expenditure to operating profit.

Capital expenditure

£145.0m

2013	£145.0m
2012	£143.7m
2011	£143.1m
2010	£167.9m

Additions to tangible fixed assets include new distribution mains and storage, new connections to existing mains, new governors and meters, and new investment in IT, land and buildings, vehicles and plant.

Replacement expenditure

£253.0m

2013	£253.0m
2012	£260.6m
2011	£256.0m
2010	£244.7m

Replacement expenditure is written off to the profit and loss account as incurred under UK GAAP. 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 to mains.

Debt to RAV ratio

59.8%

2013	59.8%
2012	63.7%
2011	67.3%
2010	67.0%

The Group's net debt to Regulatory Asset Value ('RAV') ratio. RAV is defined as Ofgem Regulatory Asset Value of both networks plus additions in excess of current allowances expected to be recovered in future periods. Debt for the purposes of the Debt to RAV ratio excludes shareholders' loans and liabilities arising from derivative financial instruments. The percentages stated are as at 31 March.

Operational

Employee lost time incidents

0.08

2013	0.08
2012	0.04
2011	0.05
2010	0.06

This is defined as the number of incidents per 100,000 hours worked resulting in employees taking time off work. This is one of the key operational metrics that is monitored on a consistent basis. Safety is one of our core Company values and is monitored closely by the Board.

Customer satisfaction: planned interruptions

8.3

2013	8.3
2012	8.0
2011	7.9
2010	8.0

Results from customer satisfaction surveys (10 = very satisfied) are based on reports obtained for the nine month period ended 31 December for Southern Gas Networks and Scotland Gas Networks. Planned interruptions on our replacement, capital or routine maintenance works are where timing can be predicted and the customer has been notified in advance.

Customer satisfaction: unplanned interruptions

9.1

2013	9.1
2012	8.6
2011	8.4
2010	8.3

Results from customer satisfaction surveys (10 = very satisfied) are based on reports obtained for the nine month period ended 31 December for Southern Gas Networks and Scotland Gas Networks. Unplanned interruptions arise through leakage or other emergencies such as damage to the infrastructure (e.g. by burst water mains).

Escapes attendance

98.4%

2013	98.4%
2012	98.7%
2011	97.2%
2010	97.9%

This represents the proportion of uncontrolled gas escapes attended in one hour (target 97%). Uncontrolled gas escapes are defined as those where the smell of gas persists and where the gas supply is still ‘on’ at the time the customer calls. We responded to over 160,000 uncontrolled gas escapes during the year ending 31 March 2013.

Financial review

We have set out below our financial review for the year ended 31 March 2013. The results for the period are reported under UK GAAP including FRS 25, 26 and FRS 29. The comparative figures presented are for the year ended 31 March 2012, as reported in the audited financial statements, unless otherwise stated.

In considering financial performance, we use EBITDA and Adjusted EBITDA. EBITDA is calculated by adding back goodwill amortisation and depreciation, which are non-cash costs, to operating profit. Adjusted EBITDA is calculated by adding replacement expenditure to EBITDA.

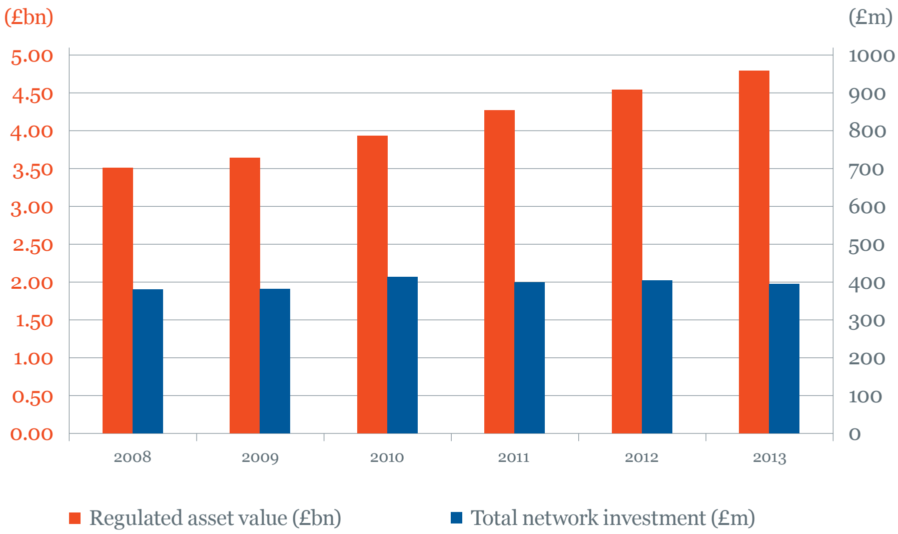
Replacement expenditure, which, under UK GAAP, is written off to the profit and loss account as it is incurred, improves the future safety and reliability of our networks through the replacement of older gas pipes with modern pipes. Ofgem treats 50% of projected replacement expenditure as recoverable during the year and 50% as recoverable over future years. Accordingly, we believe the use of these adjusted measures best illustrates the underlying performance of our business.

Key financial highlights

	2013 £m	2012 £m	2011 £m
Turnover	**965.3**	928.7	802.0
Adjusted EBITDA	**601.5**	590.1	483.5
Net finance costs	**(237.9)**	(231.5)	(234.8)
Loss for the financial year	**(20.7)**	(20.5)	(102.2)
Replacement expenditure	**253.0**	260.6	256.0
Capital expenditure	**145.0**	143.7	143.1
Long term debt*	**3,430.6**	3,402.7	3,159.8
Regulated Asset Value	**4,783.0**	4,540.0	4,270.0

*excludes shareholder loans

Regulated asset value and total network investment



Financial performance

Turnover for the year has increased from £928.7m to £965.3m due to regulatory settlement, inflation and NTS capacity income. NTS capacity income is a pass through cost which was settled directly by gas shippers in prior years. The majority of turnover was earned from charges for the provision of gas transportation capacity to various gas shippers as well as revenue based upon gas volumes transported in the year.

Adjusted EBITDA for the year increased from £590.1m to £601.5m mainly due to the increase in revenues.

Network investment

Investment in the distribution network is a key priority to maintain safety and integrity. The total network investment in replacement and capital expenditure was £398m (2012: £404.3m) continuing the sustained level of investment through to the end of this price control period. As a result of this investment, the Regulatory Asset Value increased by 5.4% in the year from £4.54bn to £4.78bn.

Replacement expenditure

We renew the old iron pipes with modern polyethylene pipes to improve the safety of the existing network. Expenditure on replacement of iron pipes reduced to £253.0m from £260.6m. In the prior year some work was advanced ahead of the London Olympics in July 2012 which has contributed largely to the comparative decrease.

During the year we replaced 1,124km of metallic pipe, a decrease of 6.5% from 2012 (1,202km).

Principal risks and uncertainties

As well as the opportunities the Group has to grow and develop the business, certain risks and uncertainties are faced in achieving its objectives. The principal risks and uncertainties identified are as follows:

- Regulatory price control treatments of certain costs and allowed regulatory rate of return on investments;
- Changes in laws or regulation affecting the business, for example environmental or health and safety law or regulation;
- Breaches of laws or regulation affecting the business, or breaches of licence conditions;
- Credit market conditions, including the availability and cost of financing and re-financing;
- Failure of the network or other critical non-network operations;
- Pension scheme funding requirements; and
- Changes in tax allowances or rates.

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 28 to 30.

Financial review continued

Capital expenditure

Total capital expenditure remained in line with prior year at £145.0m (2012: £143.7m). Capital expenditure is incurred to ensure the networks continue to operate at minimum agreed pressures and sufficient storage capacity is available to meet instances of peak demand. New connections or increases in capacity to the networks also necessitate capital expenditure.

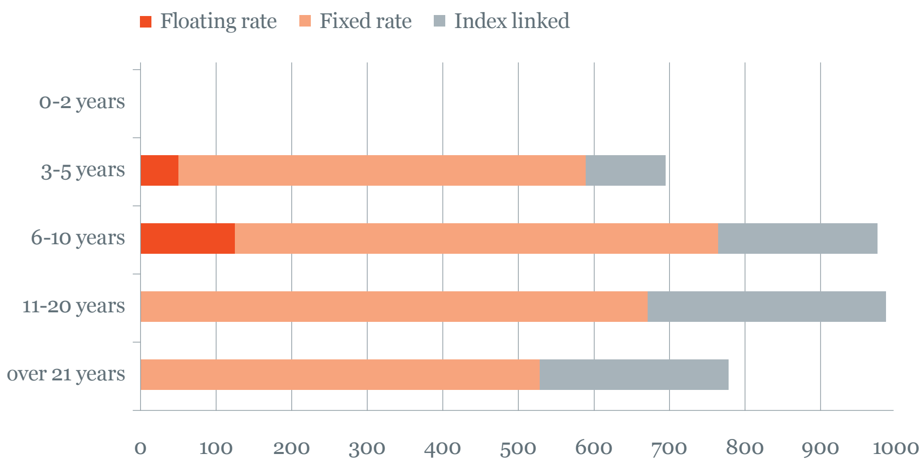
Treasury policies and capital structure

Financing consists of a mixture of equity, loans from shareholders and long-term debt. The investments and operations are mainly financed by long-term bonds and bank borrowings. Our 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 page 26.

As a matter of policy, a minimum of 75% of debt excluding shareholders' loans 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 the desired profile.

We manage the maturities of debt and facilities to ensure no significant refinancing is required in any one period. By avoiding significant financing pressure in any one period we can access competitively priced debt. In addition, the debt interest outflows are managed to ensure a competitive interest risk profile to allow us to meet our financing objective of at least 75% fixed rate or index linked interest.

Long-term debt maturity profile



At 31 March 2013, total debt (before issue costs), excluding shareholders' loans and liabilities arising from derivative financial instruments, amounted to £3,444.3m (2012: £3,418.3m) and the debt to RAV ratio was 59.8%[1] (2012: 63.7%). Of the total long-term borrowings at 31 March 2013, excluding shareholders' loans and after taking into account the effect of interest rate swaps, 87.2% were at either fixed rates of interest or were index-linked (2012: 87.2%).

The net interest costs for the year were £237.9m (2012: £231.5m). The net mark to market loss for the year ended 31 March 2013 was £2.1m, compared with a gain of £9.0m in 2012. Accretion charges on index linked bonds were lower at £26.2m (2012: £40.8m).

At 31 March 2013, there was a net derivative liability of £32.0m before tax on the balance sheet (2012: £36.2m).

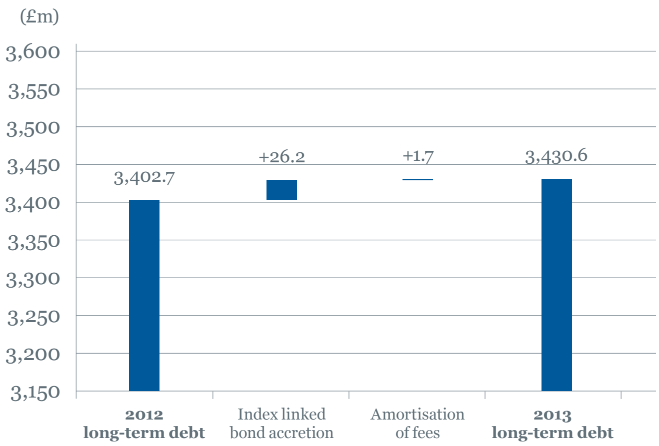
Appropriate interest rate swap contracts are used to achieve the target interest risk profile. FRS 29 requires these swaps to be valued at 'fair value'. This is calculated using market based interest rate information at the year end. No new derivative contracts were entered into during the year.

In line with the gearing objectives, we believe in maintaining a strong balance sheet and an investment grade credit rating. The credit ratings of our Southern and Scotland network companies as at 31 March 2013 were:

- 'BBB+' with stable outlook (Fitch ratings);
- 'BBB' with stable outlook (Standard & Poors); and
- 'Baa1' with stable outlook (Moody's).

[1] This represents the weighted average of the individual Southern and Scotland network ratios.

Movement in long-term debt



We remain well placed to issue competitively priced debt in the capital markets.

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 our 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 our seasonal working capital requirements.

No significant financing activities were undertaken during the year. We remain well placed to issue competitively priced debt in the capital markets. As at 31 March 2013, the revolving credit facility remained fully undrawn at £280m (2012: £280.0m). The revolving credit facility is in place until December 2016.

Net cash inflow from operating activities for the year amounted to £333.0m (2012: £310.3m), the increase is primarily due to the level of transportation revenues compared with last year.

The net cash outflow from returns on investments and servicing of finance was £203.3m (2012: £196.7m) with the increase being attributable to the issue of new debt. Net investment cash outflow for the year was £128.8m (2012: £125.2m) reflecting an increase in capital expenditure during the year due to the ongoing capital improvement programme. After taking into account movements in short-term deposits and financing items, overdrafts decreased by £1.7m in the year (2012: decrease of £2.4m).

During the year we paid dividends of £60m (2012: £130m).

Financial review continued

Pension commitments

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

In accordance with FRS 17 (Retirement benefits), our balance sheet accounts for any pension asset or liability. The net pension liability as at 31 March 2013 was £62.1m (2012: £83.5m).

Following the valuation carried out by the scheme's actuary as at 31 March 2012, annual special pension contributions remain at £23.5m annually until 31 March 2025 to repair the deficit in the defined benefit pension scheme. Employer normal contributions remain at 37.3%.

Counterparty credit risk

We transact with banks for the provision of interest rate and if necessary currency hedging transactions. We maintain a minimum credit rating requirement of 'A' or equivalent with our counterparties, however we recognise that at times the market conditions for banks can be unusually tight.

At the year end there was £39.9m (2012: £34.0m) receivable and £210.3m (2012: £220.4m) payable relating to financial instruments with bank counterparties.

Dividend policy

Our policy is to distribute to shareholders any available surplus funds, after taking into account the cash requirements needed to continue to invest in the business and our level of gearing.

Accounting policies

Our 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 and, as previously highlighted in this report, operating profit is stated after writing off replacement expenditure during the year.

Chris Brook

Chris Brook
Chief Financial Officer
25 July 2013

The total network investment in replacement and capital expenditure was £398m, continuing the sustained level of investment through to the end of this price control period.

Statement of Directors' responsibilities

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). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

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

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

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

The Directors confirm to the best of their knowledge that:

- The financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole as at 31 March 2013; and
- The Directors' report includes a fair and true view of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of its principal risks and uncertainties.

Signed on behalf of the Board of Directors of Scotia Gas Networks Limited:

Gregor Alexander
Chairman
25 July 2013

Board of Directors

Board members

Gregor Alexander
Chairman

Gregor joined the Board at its inception and was appointed the Chairman of SGN 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.

Robert McDonald
Director

Robert joined the Board in July 2006. He is Managing Director Regulation and Strategy at SSE plc and has previously worked with the industry's regulatory body. Robert is a member of the Audit Committee.

Sebastien Sherman
Director

Sebastien joined the Board in March 2007. He is Senior Vice President at Borealis Infrastructure Management Inc. He is Chairman of the Audit Committee and a member of the Safety, Health and Environmental Advisory Committee.

Juzar Pirbhai
Director

Juzar joined the Board in March 2013 and Teachers' Infrastructure Group in 2006. He is active in the oversight of a number of portfolio companies in the regulated utility sector. Previously he worked with Ernst & Young LLP and is a Chartered Accountant.

James McPhillimy
Director

James joined the Board at its inception. He is Managing Director Group Services at SSE plc. James is Chairman of the Safety, Health and Environmental Advisory Committee and a member of the People and Reward Committee.

Olivia Steedman
Director

Olivia joined the Board in July 2008. She is a Vice President at Ontario Teachers' Pension Plan Board and is a member of the Audit Committee.

Senior management team

Natalie Flageul
Director

Natalie joined the Board 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.

John McManus
Director

John joined Borealis Infrastructure in 2001 and now leads their London Office. He is jointly responsible for managing the Borealis transaction team and is a Board member for major investments including Bruce Power, Associated British Ports and High Speed One. John joined the board in March 2012.

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.

John Morea and Chris Brook are the senior managers who attend Board meetings.

Registered office
St Lawrence House
Station Approach
Horley, Surrey
RH6 9HJ

Registered auditor
Deloitte LLP
Chartered Accountants and Statutory Auditor, London

Registered number
04958135

Directors' report

The Directors present their report and the audited consolidated financial statements for the year ended 31 March 2013. The financial statements consolidate the financial statements of the Company and its subsidiary undertakings (together the 'Group').

Principal activities

The Company is a holding company which does not trade.

The subsidiary undertakings principally affecting the profits or net assets of the Group in the year are listed in note 13 to the financial statements.

The Group's principal activity is the development, administration, maintenance and safe operation of the Southern and Scotland regional gas distribution systems and the supply of associated transportation, connection and metering services. It will continue these activities for the foreseeable future.

Directors

The Directors of the Company who served during the year ended 31 March 2013, are listed below:

Gregor Alexander (Chairman)
Stephen Dowd (resigned 6 March 2013)
Robert McDonald
James McPhillimy
Sebastien Sherman
Olivia Steedman
Natalie Flageul
John McManus
Juzar Pirbhai (appointed 26 March 2013)

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, the Company 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 Group are set out in the Financial Review on pages 8 to 22.

Results and dividends

The consolidated profit and loss account is set out on page 32 and is reviewed on pages 18 to 22. The Group paid interim dividends of £60.0m (2012: £130.0m). The Directors do not recommend the payment of any final dividend for the year (2012: £nil).

Financial risk management

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

Interest rate risk

The Group has interest bearing liabilities and as a matter of policy a minimum of 75% of debt, excluding shareholder loans, which are maintained at either fixed rates of interest or index-linked. The Group uses interest rate swaps, where necessary, in order to achieve the desired profile.

Liquidity risk

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

Foreign exchange risk

All of the Group's borrowings are currently denominated in 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 Sterling, cross currency swaps would be used to fully hedge the borrowings into Sterling.

Credit risk

Counterparty credit risks arising from financial derivatives are managed through the maintenance of financial limits, subject to a minimum credit rating of 'A' or equivalent allocated by a recognised major ratings group. 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.

Pricing risk

The Group's gas transportation charges are subject to price control formulae set within the regulatory regime. The Group's maximum allowed revenue in a given price period is dependent upon a number of factors that are not known in advance (such as actual transportation volumes and performance against incentives) 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 and incentive performance, 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.

Charitable contributions

The Group made charitable donations of £93,000 in the year (2012: £78,000) in support of community and employee initiatives across its operations.

There were no political donations in either the current or prior year.

Employees

The Group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the Group. Participation by employees generally is encouraged through team meetings, briefings, an internal newspaper and an intranet site. The Chief Executive Officer and other senior executives regularly communicate with employees through these channels and 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 Group continues and that appropriate training and development is arranged. It is the policy of the Group that the training, career development and promotion of disabled persons should, as far as possible, be identical to that of other employees.

Creditors payment policy

The Group is committed to maintaining good commercial relationships with its creditors and suppliers and its current policy concerning payment is to:

- Agree the terms of payment with those creditors/suppliers when agreeing the terms of each transaction;
- Ensure that those creditors/suppliers were made aware of the terms of payment by inclusion of the relevant terms in contracts; and
- Pay in accordance with its contractual and other legal obligations.

The payment policy applies to all payments to creditors/suppliers for revenue and capital supplies of goods and services without exception.

At 31 March 2013, the Group had an average of 34 days (2012: 35 days) outstanding in its trade creditors. The Company has not traded in either the current or prior year and accordingly has no trade creditors.

Going concern

The Group's financial position, cash flows, liquidity position and borrowing facilities together with the factors likely to affect its future performance and the Group's principal risks and uncertainties are set out in the Financial Review on pages 8 to 22. The Group's financial risk management objectives and risk exposures are set out above.

As stated in the Operational and Financial Review the Group operates the regulated gas distribution networks in South of England and Scotland. The revenue of the Group is regulated by Ofgem via established price control mechanisms based on the distribution network capacity. The Group has considerable financial resources together with committed financing facilities as discussed in note 16 to finance the current and future operations. The Group's forecasts and projections, taking into account reasonably possible changes in trading performance, show that the Group should be able to operate within the level of its current facilities. As a consequence, the Directors believe that the Group 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 and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

Auditor

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

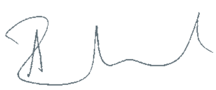
1) So far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware; and

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 provisions of section 418 of the Companies Act 2006.

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

By Order of the Board



Nicola Shand
Company Secretary
25 July 2013

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, being unlisted, is not subject to the UK Financial Reporting Council's UK Corporate Governance Code[1] (the 'Governance Code') and the Board of Directors does not believe that all of the guidance set out in the Governance Code is applicable to the Company. However, for the purposes of this statement, the Directors have applied the Governance 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. It has overall responsibility for leading and controlling the Group as well as its financial and operational performance.

As a commercial joint venture, the composition of the Board reflects the shareholders' interests in the consortium. Each of the Directors is an employee of a shareholder or an affiliate of a shareholder of the Company. As the relationship of the shareholders is governed by a Shareholders' and Governance Agreement, any conflict of interest in the position of the Directors would be addressed in accordance with the provisions of the Shareholders' and Governance Agreement. Directors are nominated to the Board in accordance with the terms of the Shareholders' and Governance Agreement. The Directors have been briefed on the duties that have been conferred on them under the Companies Act 2006.

The powers of the Directors are set out in 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. This schedule is reviewed regularly. 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 six meetings during the year.

Board constitution and appointments

The Board 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.

Biographical details for each of the Directors are set out on pages 24 to 25.

Chairman

Gregor Alexander was appointed as Chairman on 26 July 2011 for a three year period, succeeding Stephen Dowd.

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 24.

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.

Directors' remuneration

The Directors did not receive any remuneration for their services to the Company, or to the Group, during the year ended 31 March 2013 or in the prior year. Accordingly, no further information is required to be disclosed.

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

[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).

of the Directors' reported actual and potential conflicts of interest and the Board then considered and authorised 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 Safety, Health and Environmental Advisory Committee, the People and Reward 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.

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 in the table on page 30.

Audit Committee

The current members of the Audit Committee are Sebastien Sherman (Committee Chairman), Graham Laughland (appointed in 2009 as independent member of the audit committee), Gregor Alexander, Robert McDonald and Olivia Steedman. Natalie Flageul and Juzar Pirbhai also regularly attend the Audit Committee.

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.

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 James McPhillimy (Committee Chairman), Natalie Flageul (who was appointed as a Committee member on 20 November 2012), Juzar Pirbhai (who was appointed as a Committee member on 26 March 2013, succeeding Stephen Dowd), Sebastien Sherman, 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 auditor 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 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 Olivia Steedman (who was appointed as Committee Chair on 26 March 2013, succeeding Stephen Dowd), John McManus and James McPhillimy.

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 Chairman 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. Four meetings were held during the year.

Corporate governance statement continued

Finance Committee

The current members of the Finance Committee are Olivia Steedman, Gregor Alexander and Sebastien Sherman.

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. Two 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 standing 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.

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 period 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.

	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*	6	6	3	3	1	1	–	–	1	2
Stephen Dowd**	5	5	–	–	2	2	2	2	–	–
Juzar Pirbhai***	1	1	1	1	–	–	1	1	–	–
Natalie Flageul***	6	6	3	3	–	–	1	1	–	–
Robert McDonald	6	6	3	3	–	–	–	–	–	–
James McPhillimy	4	6	–	–	3	4	2	3	–	–
John McManus	5	6	–	–	4	4	–	–	–	–
Olivia Steedman	6	6	3	3	1	1	–	–	2	2
Sebastien Sherman	5	6	2	3	–	–	2	3	2	2
Graham Laughland	n/a	n/a	2	3	n/a	n/a	n/a	n/a	n/a	n/a

* Gregor Alexander attended the March meeting of the People and Reward Committee in Jim McPhillimy's absence.

** With effect from 6 March 2013, Stephen Dowd resigned as Board Director and was replaced by Juzar Pirbhai as a Board Director.

*** During the course of their respective appointments as Directors of the Board, both Natalie Flageul and Juzar Pirbhai were invited to attend meetings of the Audit Committee.

Independent auditor's report to the members of Scotia Gas Networks Limited

We have audited the financial statements of Scotia Gas Networks Limited for the year ended 31 March 2013 which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the consolidated and company balance sheets, the consolidated cash flow statement, the reconciliation of net cash flow to movement in net debt and the related notes 1 to 27. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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.

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statements, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practice Board's Ethical Standards for Auditors.

Scope of the audit of financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion

In our opinion the financial statements:

- give a true and fair view of the state of the Group's and the parent Company's affairs as at 31 March 2013 and of the Group's loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on matters prescribed in the Companies Act 2006

In our opinion the information in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company 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.

Makhan Chahal
(Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and
Statutory Auditor
London, United Kingdom
25 July 2013

Consolidated profit and loss account for the year ended 31 March 2013

	Notes	2013 £m	2012 £m
Turnover	1, 2	**965.3**	928.7
Net operating costs	3	**(740.0)**	(717.8)
Operating profit	3	**225.3**	210.9
Income from fixed asset investments	13	**0.8**	0.6
Interest receivable and similar income	6	**6.1**	25.0
Interest payable and similar charges	7	**(244.0)**	(256.5)
Loss on ordinary activities before taxation	4	**(11.8)**	(20.0)
Tax charge on loss on ordinary activities	8	**(8.9)**	(0.5)
Loss for the financial year	20	**(20.7)**	(20.5)

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

Consolidated statement of total recognised gains and losses for the year ended 31 March 2013

	Notes	**2013 £m**	2012 £m
Loss for the financial year	20	**(20.7)**	(20.5)
Cash flow hedges (net of deferred tax)	20	**(1.1)**	(27.9)
Actuarial gain/(loss) recognised on defined benefit pension scheme	26	**10.1**	(69.1)
Movement on deferred tax relating to pension scheme	26	**(4.0)**	14.3
Total recognised losses for the year		**(15.7)**	(103.2)

Balance sheets as at 31 March 2013

	Notes	Group 2013 £m	Group 2012 £m	Company 2013 £m	Company 2012 £m
Fixed assets					
Intangible assets – goodwill	11	**402.5**	412.0	**–**	–
Tangible assets	12	**3,570.2**	3,538.9	**–**	–
Investments	13	**0.2**	0.2	**2,028.4**	2,028.4
		3,972.9	3,951.1	**2,028.4**	2,028.4
Current assets					
Debtors	14	**101.3**	92.6	**–**	91.4
Short term deposits		**13.5**	83.0	**13.5**	83.0
		114.8	175.6	**13.5**	174.4
Creditors: amounts falling due within one year	15	**(335.2)**	(326.8)	**(568.7)**	(606.4)
Net current liabilities		**(220.4)**	(151.2)	**(555.2)**	(432.0)
Total assets less current liabilities		**3,752.5**	3,799.9	**1,473.2**	1,596.4
Creditors: amounts falling due after more than one year	16	**(3,967.1)**	(3,936.3)	**(533.6)**	(533.6)
Provisions for liabilities	18	**(384.3)**	(380.4)	**–**	–
Deferred income	12	**(161.9)**	(146.9)	**–**	–
Net (liabilities)/assets excluding pension liabilities		**(760.8)**	(663.7)	**939.6**	1,062.8
Defined benefit pension liabilities	26	**(62.1)**	(83.5)	**–**	–
Net (liabilities)/assets including pension liabilities		**(822.9)**	(747.2)	**939.6**	1,062.8
Capital and reserves					
Called up share capital	19	**200.0**	200.0	**200.0**	200.0
Hedge reserve	20	**(59.4)**	(58.3)	**–**	–
Profit and loss account	20	**(963.5)**	(888.9)	**739.6**	862.8
Shareholders' (deficit)/funds	21	**(822.9)**	(747.2)	**939.6**	1,062.8

The financial statements of Scotia Gas Networks Limited, registered number 04958135, were approved by the Board of Directors on 25 July 2013.

Signed on behalf of the Board of Directors

Gregor Alexander
Director

Sebastien Sherman
Director

Consolidated cash flow statement for the year ended 31 March 2013

	Notes	2013 £m	2012 £m
Net cash inflow from operating activities	22	**333.0**	310.3
Returns on investments and servicing of finance			
Interest paid		**(204.3)**	(197.8)
Interest received		**0.2**	0.5
Dividends received from fixed asset investments		**0.8**	0.6
Net cash outflow from returns on investments and servicing of finance		**(203.3)**	(196.7)
Taxation	8, 27	**10.4**	1.1
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(148.2)**	(145.0)
Sale of tangible fixed assets		**0.8**	0.2
Customer contributions received	12	**18.6**	19.6
Net cash outflow from capital expenditure and financial investment		**(128.8)**	(125.2)
Equity dividends paid	10	**(60.0)**	(130.0)
Net cash outflow before management of liquid resources and financing		**(48.7)**	(140.5)
Management of liquid resources			
Decrease/(increase) in short-term deposits	23	**69.5**	(37.2)
Net cash inflow/(outflow) from management of liquid resources		**69.5**	(37.2)
Financing			
Issue of debt	23	**–**	372.1
Settlement of swaps	17	**–**	(8.2)
Repayment of bank borrowings	23	**–**	(171.6)
Payments in respect of financial instruments	23	**(19.1)**	(12.2)
Net cash (outflow)/inflow from financing		**(19.1)**	180.1
Decrease in bank overdrafts	23	**1.7**	2.4

Reconciliation of net cash flow to movement in net debt for the year ended 31 March 2013

	Notes	**2013 £m**	2012 £m
Decrease in bank overdraft in the year		**1.7**	2.4
(Decrease)/increase in short-term deposits		**(69.5)**	37.2
Movement in borrowings		**19.1**	(188.3)
Change in net debt resulting from cash flows	23	**(48.7)**	(148.7)
Other non-cash changes	23	**(31.0)**	(51.9)
Net debt at beginning of year		**(4,044.6)**	(3,844.0)
Net debt at end of year	23	**(4,124.3)**	(4,044.6)

Notes to the financial statements for the year ended 31 March 2013

1. Principal accounting policies

The financial statements have been prepared in accordance with applicable accounting standards in the United Kingdom and the Companies Act 2006.

The financial statements of the Group present the results for the year ended 31 March 2013. The comparative period presented is the year ended 31 March 2012.

A summary of the more significant Group accounting policies, which have been applied consistently in both years is as follows.

Basis of preparation

These financial statements have been prepared under the historical cost convention except that assets and liabilities were stated at fair value when acquired, certain derivative financial instruments are recorded at fair value, and certain fixed asset investments are recorded on a valuation basis.

The financial statements have been prepared on the going concern basis as set out in the Directors' report.

Basis of consolidation

The financial statements consolidate the financial statements of the Company and its subsidiary undertakings drawn up to 31 March each year. Subsidiaries are those entities controlled by the Group or the Company.

Subsidiaries acquired are consolidated in the financial statements of the Group from the date that control commences until the date control ceases, using the acquisition method of accounting.

Intra-Group balances and any unrealised gains and losses or income and expenses arising from intra-Group transactions, are eliminated in preparing the consolidated financial statements.

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 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.

Replacement expenditure

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

Taxation

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

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more or a right to pay less tax in the future have occurred at the balance sheet date, with the following exceptions:

- Provision is made for gains on disposal of fixed assets that have been rolled over into replacement assets only where, at the balance sheet date, there is a commitment to dispose of the replacement assets with no likely subsequent rollover or available capital losses;
- Provision is made for gains on revalued fixed assets only where there is a commitment to dispose of the revalued assets and the attributable gain can neither be rolled over nor eliminated by capital losses; and
- Deferred tax assets are recognised only to the extent that the Directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing difference can be deducted.

Deferred tax is measured on an undiscounted basis.

Notes to the financial statements for the year ended 31 March 2013 continued

1. Principal accounting policies (continued)

Intangible assets – goodwill

Goodwill is capitalised and amortised on a straight line basis to the profit and loss account over its expected useful life. Goodwill represents the excess of the fair value of the consideration paid for the acquisition of businesses over the fair value of the separable net assets acquired.

The useful life of goodwill related to acquired businesses has been estimated to be 50 years.

A review for impairment of goodwill is carried out at the end of each financial year. Impairment reviews comprise a comparison of the carrying amount of the goodwill with its recoverable amount (the higher of net realisable value and value in use). To the extent that the carrying amount exceeds the recoverable amount, the goodwill is impaired and an impairment loss is recognised in the profit and loss account.

Fixed asset investments

Except for the Company's investment in shares of Southern Gas Networks plc and Scotland Gas Networks plc, 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.

Investments in the shares of distribution networks which include Southern Gas Networks plc and Scotland Gas Networks plc are stated at market value as at the date of their last valuation under the alternative valuation rules in the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

Tangible fixed assets

Tangible fixed assets are stated at cost less depreciation and any provision for impairment. The cost is the purchase cost of the asset, together with any directly attributable costs of acquisition. In respect of assets purchased as part of a business combination, the cost is the fair value of the assets acquired.

The carrying values of tangible fixed assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

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

Freehold buildings	Up to 50 years
Leasehold buildings	Over the shorter of lease term and 50 years
Plant and machinery:	
– Mains and services	60 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.

Grants and contributions

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. Deferred income in respect of revenue grants and contributions is included within creditors: amounts falling due within one year.

Finance leases

Assets held under finance leases, which confer rights and obligations similar to those attached to owned assets, are capitalised as tangible fixed assets and are depreciated over the shorter of the lease terms and their useful lives. The capital elements of future lease payments are recorded as liabilities, while the interest elements are charged to the profit and loss account.

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, except where the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate is shorter than the full lease term, in which case the shorter period is used.

Pensions
Defined benefit pension scheme
The amounts charged to the profit and loss account are the current service costs and gains and losses on settlements and curtailments. They are included within staff costs. Past service costs are recognised immediately in the profit and loss account if the benefits have vested. If the benefits have not vested immediately the costs are recognised over the period until vesting occurs. The interest cost and the expected return on the assets are shown as a net amount of other finance costs or credits within interest payable or receivable. Actuarial gains and losses are recognised immediately in the consolidated statement of total recognised gains and losses.

The defined benefit scheme is funded, with the assets of the scheme held separately from those of the Group, in separate trustee administered funds. Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date.

The resulting defined benefit asset or liability, net of the related deferred tax, is presented separately after other net assets on the face of the balance sheet. Any pension asset is recognised in the balance sheet to the extent that the benefits may be derived from the surplus in the form of reduced cash contributions in the future or cash refunds.

Defined contribution pension schemes
The Group also operates defined contribution pension schemes. The assets of the schemes are held separately from those of the Group in independently administered funds. The amounts charged to the profit and loss account represent the contributions payable to the schemes in the period. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

Provisions
A provision is recognised in the balance sheet when the Group 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.

Financial instruments
The Group'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.

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).

Notes to the financial statements for the year ended 31 March 2013 continued

1. Principal accounting policies (continued)

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.

Impairment of financial assets
Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

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

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Derecognition of financial assets
The Group 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.

Trade debtors
Trade debtors are initially recognised at fair value. The carrying amount is reduced through the use of an allowance account. Appropriate allowances 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 allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

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

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

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 Group 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 group 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 Group's documented risk management or investment strategy and information about the Group is provided internally on that basis; or
- It forms part of a contract containing one or more embedded derivatives and FRS 26 Financial Instruments: Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL.

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.

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.

De-recognition of financial liabilities
The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire.

Derivative financial instruments and hedge accounting
The Group 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 Group 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 Group 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. Changes in fair value of derivatives that are designated and are effective as fair value hedges are recognised in the profit and loss account but effectively offset changes in fair value of the hedged item.

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. Segmental reporting

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.

3. Operating profit and net operating costs

	2013 £m	2012 £m
Turnover	**965.3**	928.7
Distribution costs	**(744.4)**	(721.3)
Profit on disposal of fixed assets	**0.8**	0.2
Other operating income	**3.6**	3.3
Total net operating costs	**(740.0)**	(717.8)
Operating profit	**225.3**	210.9

Distribution costs include the costs of operating the distribution network together with depreciation, goodwill amortisation and replacement expenditure.

Notes to the financial statements for the year ended 31 March 2013 continued

4. Loss on ordinary activities before taxation

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

	2013 £m	2012 £m
Auditor's remuneration	0.3	0.4
Goodwill amortisation	9.5	9.6
Depreciation of owned assets	113.7	109.0
Profit on disposal of fixed assets	(0.8)	(0.2)
Replacement expenditure	253.0	260.6
Rentals under operating leases – other assets	0.8	0.5

Auditor's remuneration for the Group comprises £163,000 (2012: £175,000) in respect of statutory and regulatory audit services, £50,000 (2012: £50,000) in respect of other services pursuant to legislation, £nil (2012: £44,000) in respect of bond issue assurance work, £76,000 (2012: £24,000) in respect of IT consultancy services, £nil (2012: £75,000) in respect of regulatory consulting services and £nil (2012: £35,000) in respect of tax consultancy services.

Auditor's remuneration in respect of statutory audit services for the Company amounted to £12,000 (2012: £10,000).

In addition to the above services, the Group's auditor acted as auditor to the Scotia Gas Networks Pension Scheme and fees of £16,000 (2012: £16,000) have been charged by the auditor to the Group in respect of these services.

5. Employee information and Directors' emoluments

The Group had 3,676 full time equivalent employees as of 31 March 2013 (2012: 3,787). The average monthly number of full time equivalent employees during the year was 3,740 (2012: 3,854).

The Directors did not receive any remuneration for their services to the Group during the year, or during the prior 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 Group.

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

	2013 £m	2012 £m
Staff costs		
Wages and salaries	138.2	136.5
Social security costs	13.3	12.8
Pension costs	28.2	23.7
	179.7	173.0

The Company had 8 employees as of 31 March 2013 (2012: 9).

6. Interest receivable and similar income

	2013 £m	2012 £m
Interest receivable on short-term deposits	0.2	0.5
Other finance income:		
Movement on financial derivatives (see note 17)	5.9	22.6
Net pension credit (see note 26)	–	1.9
Total interest receivable and similar income	6.1	25.0

7. Interest payable and similar charges

	2013 £m	2012 £m
Bank loans	**0.2**	0.2
Index-linked bond interest	**44.7**	58.6
Other interest payable on bonds	**115.4**	107.7
Shareholders' loan interest (see note 27)	**66.5**	66.7
Finance leases and hire purchase contracts	**0.1**	–
Other interest payable	**6.9**	7.9
Net pension charge (see note 26)	**0.5**	–
Unwind of discounts in provisions (see note 18)	**9.7**	15.4
	244.0	256.5

8. Tax charge on loss on ordinary activities

a) Analysis of the tax charge on loss on ordinary activities

	2013 £m	2012 £m
Current tax		
Corporation tax at 24% (2012: 26%)	**–**	–
Adjustment in respect of prior year	**10.4**	1.1
Total current tax credit	**10.4**	1.1
Deferred tax		
Deferred tax charge for the year	**(9.4)**	(1.6)
Adjustments in respect of prior year	**(9.9)**	–
Total deferred tax charge for the year	**(19.3)**	(1.6)
Total tax charge on loss on ordinary activities	**(8.9)**	(0.5)

b) Factors affecting the current tax credit for the year

	2013 £m	2012 £m
Loss on ordinary activities before tax	**(11.8)**	(20.0)
Loss on ordinary activities multiplied by standard rate of corporation tax in the UK of 24% (2012: 26%)	**2.8**	5.2
Effects of:		
Non taxable income	**0.2**	0.2
Deferred tax on accelerated capital allowances	**0.5**	5.5
Deferred tax recognised on unutilised losses	**(0.4)**	(0.8)
Utilisation of losses brought forward	**15.2**	5.0
Depreciation on non-qualifying assets	**(7.0)**	(7.6)
Other short-term timing differences	**4.7**	10.6
Tax losses not recognised	**(13.2)**	(15.0)
Expenses not deductible for tax purposes	**(2.8)**	(3.1)
Adjustment in respect of prior year – proceeds from sale of tax losses	**10.4**	1.1
Current tax credit	**10.4**	1.1

Legislation was introduced in the Finance Bill 2012 to reduce the main corporation tax rate to 23% from 1 April 2013. As this rate change has been substantively enacted at the balance sheet date, deferred tax has been restated accordingly in these financial statements. This has the effect of reducing the Group's net deferred tax liabilities at 31 March 2013 by £10.6m (2012: £18.7m).

Notes to the financial statements for the year ended 31 March 2013 continued

8. Tax charge on loss on ordinary activities (continued)

In addition to the announcement made in the March 2012 Budget to reduce the main Corporation Tax rate to 22% from 1 April 2014, the Chancellor announced a further 1% reduction to 21% in his Autumn Statement in December 2012. It was also announced in the March 2013 Budget that the main Corporation Tax rate would reduce to 20% from 1 April 2015. As these changes are intended to be put into the Finance Bill 2013 the revised rates are expected to be substantively enacted by July 2013. It has not yet been possible to quantify the full anticipated effect of these reductions, although they will further reduce the Group's future current tax charge and reduce the Group's deferred tax liabilities accordingly.

9. Loss of the Company for the financial year

The Company's loss for the year amounted to £63.2m (2012: Loss of £63.4m). In accordance with the exemption available under section 408 of the Companies Act 2006, no separate profit and loss account is presented in respect of the Company.

10. Dividends

	2013 £m	2012 £m
Equity shares		
Interim dividends paid of 12.7646p (2012: 27.6566p)	**60.0**	130.0

11. Intangible fixed assets

Group

	Goodwill £m
Cost	
At 1 April 2012 and at 31 March 2013	**477.6**
Accumulated amortisation	
At 1 April 2012	65.6
Charge for the year	9.5
At 31 March 2013	**75.1**
Net book value	
At 31 March 2013	**402.5**
At 31 March 2012	412.0

The goodwill, which arose on the acquisitions of Scotland Gas Networks plc and Southern Gas Networks plc, 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 businesses acquired are 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 either the current or the prior year.

12. 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 2012	0.7	68.9	3,893.7	203.7	4,167.0
Additions	–	2.9	110.8	31.3	145.0
At 31 March 2013	**0.7**	**71.8**	**4,004.5**	**235.0**	**4,312.0**
Depreciation					
At 1 April 2012	0.1	10.1	530.2	87.7	628.1
Charge for the year	–	2.5	88.3	22.9	113.7
At 31 March 2013	**0.1**	**12.6**	**618.5**	**110.6**	**741.8**
Net book value					
At 31 March 2013	**0.6**	**59.2**	**3,386.0**	**124.4**	**3,570.2**
At 31 March 2012	0.6	58.8	3,363.5	116.0	3,538.9

Within motor vehicles and office equipment are assets held under finance leases with a net book value of £4.4m (2012: £nil).

The Company had no tangible fixed assets in either year.

The Group has received customer contributions relating to plant and machinery. In accordance with the Group's accounting policy the assets are capitalised within fixed assets and the contributions are recognised as deferred income in the balance sheet. 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:

Deferred income

	Group	
	2013 £m	2012 £m
Customer contributions brought forward	**146.9**	130.5
Customer contributions received in year	**18.6**	19.6
Amortisation in year	**(3.6)**	(3.2)
	161.9	146.9

The Company has no deferred income.

Notes to the financial statements for the year ended 31 March 2013 continued

13. Fixed asset investments

Cost or valuation and net book value

	Group £m	Company £m
Shares in Group undertakings		
At 1 April 2012 and at 31 March 2013	–	2,028.4
Other investments		
At 1 April 2012 and at 31 March 2013	0.2	–
	0.2	**2,028.4**

The Company's investments in Southern Gas Networks plc and Scotland Gas Networks plc were valued at 16 June 2011 by an independent firm of professional valuers. The revaluation was undertaken using a discounted cash flow technique.

Other fixed asset investments

Other fixed asset investments relate to the Group's investments in Xoserve Limited, which provides transportation transactional services on behalf of all the major gas network transportation companies. The Group holds 23.1% (2012: 23.1%) of the ordinary shares of Xoserve Limited.

During the year the Group received dividends of £0.8m (2012: £0.6m) in relation to this investment.

Interests in Group undertakings

Details of the principal subsidiary undertakings at the end of the year, which are directly wholly owned by the Company, are as follows:

Name of subsidiary	Description of shares held	Country of registration	Principal activities
Southern Gas Networks plc	160,174,772 ordinary shares of £1 each	England & Wales	Development, administration, maintenance and operation of regional gas distribution system and supply of transportation services.
Scotland Gas Networks plc	49,392,787 ordinary shares of £1 each	Scotland	Development, administration, maintenance and operation of regional gas distribution system and supply of transportation services.
SGN Contracting Limited	1 ordinary share of £1	England & Wales	Supply of contracting services.
SGN Connections Limited	1 ordinary share of £1	England & Wales	Supply of gas connections services.
SGN Commercial Services Limited	1 ordinary share of £1	England & Wales	Meter asset manager and supply of commercial services.

14. Debtors

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Amounts falling due within one year				
Trade debtors	**52.8**	50.3	**–**	–
Amounts owed by Group undertakings	**–**	–	**–**	91.4
Prepayments and accrued income	**8.6**	8.3	**–**	–
Derivative financial instruments (see note 17)	**39.9**	34.0	**–**	–
	101.3	92.6	**–**	91.4

Trade debtors are stated net of bad debt provisions of £0.4m (2012: £0.3m) and credit note provisions of £4.9m (2012: £3.7m).

Within amounts owed by Group undertakings are loans amounting to £nil (2012: £91.4m) which incur interest at 1.5% (2012: 1.5%).

15. Creditors: amounts falling due within one year

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Bank loans and overdrafts	**3.2**	4.9	**–**	–
Obligations under finance leases and hire purchase contracts	**0.9**	–	**–**	–
Trade creditors	**51.7**	58.0	**–**	–
Amounts owed to Group undertakings	**–**	–	**546.3**	583.8
Other taxation and social security	**26.2**	26.4	**0.2**	0.2
Other creditors	**12.6**	5.1	**–**	–
Accrued interest	**70.1**	68.7	**22.2**	22.4
Other accruals	**85.4**	79.3	**–**	–
Deferred income	**13.2**	14.2	**–**	–
Derivative financial instruments (see note 17)	**71.9**	70.2	**–**	–
	335.2	326.8	**568.7**	606.4

The amounts owed to Group undertakings represents loans which incur interest at 0.5% (2012: 0.5%).

Notes to the financial statements for the year ended 31 March 2013 continued

16. Creditors: amounts falling due after more than one year

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Bonds:				
Fixed rate and index-linked:				
£165m 2.127% index-linked due 2022	**210.9**	204.6	**–**	–
£250m 2.013% index-linked due 2035	**319.4**	310.0	**–**	–
£150m 2.066% index-linked due 2025	**191.7**	186.0	**–**	–
£15m 2.580% index-linked due 2028	**17.3**	16.8	**–**	–
£125m 2.31% index-linked due 2039	**143.2**	138.7	**–**	–
£257m 4.75% fixed rate due 2017	**256.1**	255.9	**–**	–
£300m 5.25% fixed rate due 2018	**298.5**	298.2	**–**	–
£225m 4.875% fixed rate due 2034	**224.5**	224.5	**–**	–
£215m 4.875% fixed rate due 2020	**214.5**	214.5	**–**	–
£375m 4.875% fixed rate due 2029	**373.6**	373.6	**–**	–
£225m 6.38% fixed rate due 2040	**223.5**	223.5	**–**	–
£25m 3.12% fixed rate due 2018	**25.0**	25.0	**–**	–
£25m 3.25% fixed rate due 2018	**25.0**	25.0	**–**	–
£300m 4.875% fixed rate due 2023	**297.4**	297.1	**–**	–
£25m 3.634% fixed rate due 2020	**25.0**	25.0	**–**	–
£50m 3.765% fixed rate due 2020	**50.0**	50.0	**–**	–
	2,895.6	2,868.4	**–**	–
Floating rates:				
£233m floating rate loan note due 2015	**232.8**	232.8	**–**	–
£100m floating rate loan note due 2015	**99.9**	99.9	**–**	–
£80m floating rate loan note due 2043	**79.6**	79.6	**–**	–
£75m floating rate loan note due 2018	**75.0**	75.0	**–**	–
£50m floating rate loan note due 2019	**50.0**	50.0	**–**	–
	537.3	537.3	**–**	–
Total bonds	**3,432.9**	3,405.7	**–**	–
Revolving credit facility drawn	**(2.3)**	(3.0)	**–**	–
Shareholders' loans (see note 27)	**533.6**	533.6	**533.6**	533.6
Obligations under finance leases and hire purchase contracts	**2.9**	–	**–**	–
	3,967.1	3,936.3	**533.6**	533.6

The shareholder loans, which are subordinated, are redeemable at par on 31 May 2015, or may be redeemed at par by the Company by giving due notice. Interest accrues at a fixed rate of 12.5% per annum and the Company may, upon giving due notice, elect to pay some or all of the interest payable through the issuance of further loans to shareholders.

The total revolving credit facility is £280.0m and expires in December 2016.

Maturity of borrowings

	Group	
	2013 £m	2012 £m
Due within one year	**–**	–
Between one and five years	**1,125.4**	1,122.1
After five years	**2,841.7**	2,814.2
	3,967.1	3,936.3

The Company's borrowings all fall due on 31 May 2015.

The above borrowings are unsecured and are stated after the deduction of unamortised issue costs of £13.7m (2012: £15.6m). 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 2013 is £179.4m (2012: £153.2m).

Included within one and five years above are obligations under finance leases amounting to £2.9m (2012: £nil).

17. Financial instruments

The Group'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 the prospectus issued by the Company for the medium term note programme, financial derivatives are used to manage financial exposures.

The Treasury function is responsible for managing banking and liquidity requirements of the Group, risk management relating to interest rate and foreign exchange exposures and for managing the credit risk relating to banking counterparties with which it transacts. The function's operations are governed by policies determined by the Board.

Notes to the financial statements for the year ended 31 March 2013 continued

17. Financial instruments (continued)

Categories of financial instruments

The categories of financial assets and liabilities held by the Group were as follows:

	Book Value 2013 £m	Book Value 2012 £m
Financial assets held at amortised cost		
Trade debtors[1]	**52.8**	50.3
Short term deposits[1]	**13.5**	83.0
	66.3	133.3
Financial assets at fair value		
Derivative financial instruments through the profit and loss account	**39.9**	34.0
Available for sale financial assets[1]	**0.2**	0.2
Total financial assets	**106.4**	167.5

(1) The carrying amount of financial assets approximates to their fair value.

	Book Value 2013 £m	Book Value 2012 £m
Financial liabilities held at amortised cost		
Trade creditors	**51.7**	58.0
Accrued interest	**70.1**	68.7
Other accruals	**85.4**	79.3
Bank loans and overdrafts	**3.2**	4.9
Finance lease liabilities	**3.8**	–
Bonds	**3,432.9**	3,405.7
Shareholder loans	**533.6**	533.6
	4,180.7	4,150.2
Financial liabilities at fair value		
Bonds	**–**	–
Derivative financial instruments in designated hedging relationships	**71.9**	70.2
Onerous contract swaps	**138.4**	150.2
	210.3	220.4
Total financial liabilities	**4,391.0**	4,370.6

The carrying amount of financial liabilities approximates to their fair value except for bonds and shareholder loans, the fair value of which is disclosed on the next page.

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1: Valued using unadjusted quoted prices in active markets for identified financial instruments;
- Level 2: Valued using techniques based significantly on observable market data. Instruments in this category are valued using valuation techniques where all of the inputs that have a significant impact on the valuation are directly or indirectly based on observable market data;
- Level 3: Instruments in this category have been valued using a valuation technique where at least one input (which has a significant input on the financial instruments' valuation) is not based on observable market data. Where inputs can be observed from market data with not undue cost and effort, the observed input is used. Otherwise management determines a reasonable estimate for the input.

An analysis of financial assets and liabilities that are recorded at fair value at 31 March 2013 is as follows:

	2013			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
At fair value through profit and loss				
– other financial assets (derivatives)	–	39.9	–	39.9
	–	**39.9**	**–**	**39.9**
Financial liabilities				
At fair value through profit and loss				
– other financial liabilities (onerous contract swaps)	–	138.4	–	138.4
Derivatives used for hedging	–	71.9	–	71.9
	–	**210.3**	**–**	**210.3**

	2012			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
At fair value through profit and loss				
– other financial assets (derivatives)	–	34.0	–	34.0
	–	**34.0**	**–**	**34.0**
Financial liabilities				
At fair value through profit and loss				
– other financial liabilities (onerous contract swaps)	–	150.2	–	150.2
Derivatives used for hedging	–	70.2	–	70.2
	–	**220.4**	**–**	**220.4**

Onerous contract swaps

In 2005 the Group entered into interest rate swap contracts to fix the Group's interest cost relating to (floating rate) bridging loans which were in place at the time. In October 2005, permanent long-term capital markets debt was issued to replace floating rate bridging loans. At that point these swaps became obsolete and consequently matching swaps were transacted (under which the Group received fixed rate interest) to close out the position. The crystallised loss was recognised in the profit and loss and a discounted provision equal to the market value of the matched swaps was established under onerous contract provision (see note 18). At 31 March 2013 the provision for onerous contract swap loss was £138.4m (2012: £150.2m).

Fair values

The Group's financial instruments recorded at amortised cost are shown below together with their fair values:

	31 March 2013		31 March 2012	
	Book Value £m	**Fair Value £m**	Book Value £m	Fair Value £m
Bonds	**3,432.9**	**3,729.5**	3,405.7	3,566.7
Shareholder loans	**533.6**	**624.7**	533.6	570.9
	3,966.5	**4,354.2**	3,939.3	4,137.6

Fair values of bonds and shareholder loans have been determined by reference to closing quoted market values where available or otherwise by discounting future cash flows at their market interest rate.

The carrying value of all other financial assets and liabilities approximates to their book value.

Notes to the financial statements for the year ended 31 March 2013 continued

17. Financial instruments (continued)

Risks

Exposure to counterparty credit risk, interest rate risk, currency risk and liquidity risk arise in the normal course of business. The extent of any exposures and the policies implemented to manage them are set out below:

Credit risk

Credit risk is the risk that a counterparty will default on its obligation resulting in financial loss to the Company.

The maximum exposure to credit risk is the carrying value of financial assets as follows:

	2013 £m	2012 £m
Net trade receivables	**52.8**	50.3
Financial derivative assets	**39.9**	34.0
Short term deposits	**13.5**	83.0
	106.2	167.3

Counterparty credit risks arising from financial derivatives are managed through the maintenance of financial limits, subject to a minimum credit rating of 'A' or equivalent allocated by a recognised major ratings group. In respect of short-term cash management, counterparties are subject to review and approval according to defined criteria. The Group conducted a review of counterparty credit risk and concluded that no adjustment was required to reflect the net credit risk in arriving at the fair value of financial instruments stated in the balance sheet. At 31 March 2013 the Group was holding collateral with a fair value of £7.6m (2012: £nil).

Trade debtors 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.

Trade debtors from non-transportation income relates to consumers and businesses in relation to works for alterations, diversions, meters or damage repairs. In 2012/13 non-transportation debtors were 24.1% (2011/12: 12.5%) of net trade debtors. An impairment allowance has been set aside according to the Group's impairment policy.

The largest transportation debtor is £12.0m (2012: £12.3m). There is no material credit exposure to any one customer.

The ageing of trade debtors net of impairment allowance was:

	2013 £m	2012 £m
Not past due	**52.8**	49.7
Past due 0-30 days	**–**	0.6
Past due 31-90 days	**–**	–
Past due over 90 days	**–**	–
	52.8	50.3

The movement in the allowance for impairment of trade debtors was:

	2013 £m	2012 £m
Balance at 1 April	**0.3**	0.3
Increase in allowance for impairment	**0.1**	–
Balance at 31 March	**0.4**	0.3

In addition there are credit note provisions against trade debtors of £4.9m (2012: £3.7m).

The increase in allowance for impairment of £0.1m is in respect of debtors 30 days past. None of the trade debtors that are past due or impaired have had their terms renegotiated.

The maximum exposure to credit risk at the reporting date is the fair value of each class of debtors mentioned above.

At the end of each reporting period a review of the provision for bad and doubtful debts is performed taking in to account the age, status and risk of recovery for each debtor.

Liquidity risk

Liquidity risk, the risk that the Group will have insufficient funds to meet liabilities as they fall due, is managed through an appropriate liquidity risk framework for the management of the Group's short, medium and long-term funding and liquidity requirements. The Group manages liquidity risk by maintaining adequate reserves, banking facilities and reserve borrowing facilities by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

The contractual maturity of the Group's financial assets and liabilities are shown in the following tables. The amounts shown are gross cash inflows/(outflows) with the exception of financial derivatives settled on a net basis where the amounts represent undiscounted net cash flows. When the amount payable is not fixed, the amount disclosed is determined by reference to relevant conditions existing at the reporting date.

2013

	0-6 months £m	6-12 months £m	1-2 years £m	2-5 years £m	> 5 years £m	Contractual cash flows £m	Interest/ discounting £m	Carrying value £m
Financial liabilities loans and borrowings								
Bank overdrafts	(3.2)	–	–	–	–	(3.2)	–	(3.2)
Shareholder loans	(33.4)	(33.4)	(66.8)	(611.8)	–	(745.4)	211.8	(533.6)
Bonds	(46.9)	(78.1)	(125.5)	(951.5)	(4,492.2)	(5,694.2)	2,261.3	(3,432.9)
Finance lease liabilities	(0.5)	(0.5)	(1.0)	(2.3)	–	(4.3)	0.5	(3.8)
	(84.0)	(112.0)	(193.3)	(1,565.6)	(4,492.2)	(6,447.1)	2,473.6	(3,973.5)
Derivative financial liabilities								
Hedging interest rate swaps	(8.5)	3.0	(5.5)	1.5	(91.3)	(100.8)	68.8	(32.0)
Onerous contract swaps	(15.1)	(15.1)	(32.3)	(83.3)	(91.4)	(237.2)	98.8	(138.4)
	(23.6)	(12.1)	(37.8)	(81.8)	(182.7)	(338.0)	167.6	(170.4)
Other financial liabilities								
Trade and other creditors	(51.7)	–	–	–	–	(51.7)	–	(51.7)
Total financial liabilities	**(159.3)**	**(124.1)**	**(231.1)**	**(1,647.4)**	**(4,674.9)**	**(6,836.8)**	**2,641.2**	**(4,195.6)**

The Group expects to meets its obligations from cash balances, operating cash flows and re-financing.

Notes to the financial statements for the year ended 31 March 2013 continued

17. Financial instruments (continued)

The corresponding amounts for 2012 were as follows:

2012

	0-6 months £m	6-12 months £m	1-2 years £m	2-5 years £m	> 5 years £m	Contractual cash flows £m	Interest/ discounting £m	Carrying value £m
Financial liabilities loans and borrowings								
Bank overdrafts	(4.9)	–	–	–	–	(4.9)	–	(4.9)
Shareholder loans	(33.4)	(33.4)	(66.8)	(611.8)	–	(745.4)	211.8	(533.6)
Bonds	(47.5)	(78.9)	(126.7)	(710.6)	(4,869.9)	(5,833.6)	2,427.9	(3,405.7)
	(85.8)	(112.3)	(193.5)	(1,322.4)	(4,869.9)	(6,583.9)	2,639.7	(3,944.2)
Derivative financial liabilities								
Hedging interest rate swaps	(8.5)	2.1	(6.2)	(6.4)	(80.9)	(99.9)	63.7	(36.2)
Onerous contract swaps	(9.8)	(9.9)	(19.8)	(55.0)	(70.3)	(164.8)	14.6	(150.2)
	(18.3)	(7.8)	(26.0)	(61.4)	(151.2)	(264.7)	78.3	(186.4)
Other financial liabilities								
Trade and other creditors	(58.0)	–	–	–	–	(58.0)	–	(58.0)
Total financial liabilities	**(162.1)**	**(120.1)**	**(219.5)**	**(1,383.8)**	**(5,021.1)**	**(6,906.6)**	**2,718.0**	**(4,188.6)**

Currency risk

The Group generally transacts in sterling denominated currency with the exception of certain material purchases and bond financing.

The Group enters into cross currency swap agreements from time to time with the effect of converting contractual commitments denominated in foreign currencies into sterling obligations. At 31 March 2013 the Group had minimal foreign currency exposure in relation to purchase contract commitments, or bond financing.

Inflation risk

The Group's index-linked borrowings and interest liabilities are exposed to a risk of change in the carrying value due to changes in the UK Retail Price Index ('RPI'). This form of liability is a good match to the Group's regulated asset value which is also index-linked to RPI due to the pricing mechanism imposed by the regulator. The turnover capacity charges are also linked to RPI.

By matching liabilities and assets, index-linked debt hedges the exposure to changes in RPI and delivers cash flow benefit. The compensation for the inflation risk is recorded as payable on the balance sheet with the principal, as opposed to a cash payment.

Assuming sensitivity to the RPI does not take into account the changes to revenue or operating costs that are affected by RPI or inflation generally, the following table shows the illustrative effect on the profit and loss account that would result from a 1% movement in RPI before the effects of tax.

	2013 £m	2012 £m
Impact on profit and loss		
Index-linked bonds accretion	**8.6**	8.2
Transportation income	**(9.1)**	(9.1)
Total	**(0.5)**	(0.9)

Interest rate risk
The Group limits the impact of interest rate risk by implementing a policy of a minimum of 75% of borrowing being either at fixed or index-linked, excluding borrowing from shareholders. Derivative financial instruments are transacted to hedge risk in accordance with this policy.

The impact of a change in interest rates on financial derivatives is dependent on whether their designation is fair value through the profit or loss, or if designated as cash flow hedges then the impact will be through equity.

The following table represents the annualised impact (net of deferred tax) of 100 basis point change in short-term interest rates at the reporting date in relation to equity and profit and loss account. The analysis assumes that all other variables remain constant.

	2013 £m	2012 £m
Impact on profit and loss account		
Floating rate instruments	**(7.1)**	(7.1)
Fixed to floating swaps	**(2.7)**	(2.7)
	(9.8)	(9.8)
Impact on equity		
Floating to fixed swaps	**3.6**	3.6

Cash flow hedges
Cash flow hedges comprise floating to fixed interest rate swaps of future interest payments relating to existing bonds. Receipts and payments for the swaps and the underlying bonds are exactly matched and in accordance with FRS 26 any gain or loss that is deferred to equity is recognised in profit or loss over the period that the floating rate interest payments impact on profit.

In September 2011 the Company issued a £300m 12 year fixed rate bond. Prior to the bond issue, from July to August 2011 the Company entered into six floating to fixed rate 10 year swaps of £25m each, to hedge the fixed interest rates prevalent in the market. After the issue of fixed rate bonds, the floating to fixed rate swaps were cancelled and a loss of £8.2m was recognised.

The swaps were entered into to hedge future interest outflows on the bond and therefore were effective hedging instruments. In accordance with the requirements of FRS 26 (Financial Instruments Recognition and Measurement) the loss arising on settlement of the swaps has been recorded in equity. The loss will be recycled to profit and loss account over 10 years. As at 31 March 2013 the unamortised hedge loss balance in equity was £6.9m.

The movement before deferred tax taken to equity in respect of cash flow hedges in the year was £0.8m loss (2012: £25.4m loss). The hedge reserve movement is expected to unwind in profit or loss over the life of the swaps.

The notional principal amount of the outstanding cashflow hedges at 31 March 2013 was £363.0m (2012: £363.0m). At 31 March 2013 the fixed interest rates vary from 4.5% to 6.3% and floating rates 2.6% (Libor plus 140bp).

Fair value hedges
The Group has no fair value hedges at 31 March 2013.

Movement in derivatives included in profit and loss account
The net movement included within interest in the profit and loss account for financial derivatives is as follows:

	2013 £m	2012 £m
Net fair value gain	**5.2**	14.8
Net amounts received	**0.7**	7.8
Net movement in financial derivatives	**5.9**	22.6

In addition the movement on onerous swap contracts in the period was a loss of £8.0m (2012: £13.6m) included in discount unwind within interest payable.

Notes to the financial statements for the year ended 31 March 2013 continued

18. Provisions for liabilities

Group

	Onerous financial instruments £m	Environmental £m	Deferred tax £m	Other provisions £m	Total £m
At 1 April 2012	150.2	31.8	191.5	6.9	380.4
Arising during the year	–	0.4	–	(0.3)	0.1
Utilised during the year	(19.8)	(1.1)	–	(1.0)	(21.9)
Net movement in deferred tax	–	–	16.0	–	16.0
Amortisation of discount	8.0	1.7	–	–	9.7
At 31 March 2013	**138.4**	**32.8**	**207.5**	**5.6**	**384.3**

Onerous financial instruments

The onerous financial instruments provision relates to interest rate swap contracts which the Group holds (see note 17). The provision recorded at each balance sheet date represents the aggregate fair value of the swap contracts held. The provision will be utilised as cash settlement payments are made over the life of the swaps over the next twelve years.

Environmental

The environmental provision represents the Directors' best estimate of environmental restoration costs, where the Group 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 estimated expenditure to settle the obligation. This provision is expected to be utilised over the next eighteen years.

Deferred tax

The net movement on the deferred tax provision has arisen as a result of a surrender of tax losses during the year, offset by other movements in the year of which £15.7m is recorded as a charge to the profit and loss account and £0.3m is recorded as a charge to the statement of total recognised gains and losses.

The Company has no provisions in either year.

Deferred tax recognised in the financial statements (excluding deferred tax recognised in respect of pension liabilities – see note 26) is as follows:

	Group		Company	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Accelerated capital allowances	**(260.8)**	(271.5)	**–**	–
Deferred tax asset on losses	**31.0**	56.8	**–**	–
Deferred tax on cash flow hedges	**16.5**	16.8	**–**	–
Other timing differences	**5.8**	6.4	**–**	–
	(207.5)	(191.5)	**–**	–

The movement in provision for deferred tax is as follows:

	Group	
	2013 £m	2012 £m
At 1 April	**(191.5)**	(200.2)
Charged to profit and loss account	**(15.7)**	3.5
Charged to statement of recognised gains and losses	**(0.3)**	5.2
At 31 March	**(207.5)**	(191.5)

The Group has unrecognised deferred tax assets in respect of unutilised tax losses of £300.4m (2012: £276.7m). Deferred tax assets have been recognised in respect of tax losses to the extent that it is considered probable that these assets will be recovered. Deferred tax assets have not been recognised in respect of unutilised tax losses in the Company amounting to £69.1m (2012: £66.4m).

In accordance with FRS 19 ('Deferred tax'), deferred tax has been measured based upon a corporation tax rate of 23% (2012: 24%), being the tax rate substantively enacted at the balance sheet date.

Other provisions

This represents a provision for other legal and constructive obligations held by the Group. This provision is expected to be utilised over the next twelve years.

19. Share capital

	31 March 2013		31 March 2012	
	Number	**Value (£m)**	Number	Value (£m)
Allotted, called up and fully paid shares				
'A' ordinary shares of 42.55p (2012: 42.55p) each	**235,025,002**	**100.0**	235,025,002	100.0
'B' ordinary shares of 42.55p (2012: 42.55p) each	**117,512,501**	**50.0**	117,512,501	50.0
'C' ordinary shares of 42.55p (2012: 42.55p) each	**117,512,501**	**50.0**	117,512,501	50.0
Total	**470,050,004**	**200.0**	470,050,004	200.0

The 'A', 'B' and 'C' ordinary shares rank pari passu in all respects.

20. Reserves

	Hedge reserve		Profit and loss account	
	Group £m	Company £m	Group £m	Company £m
At 1 April 2012	(58.3)	–	(888.9)	862.8
Loss for the financial year	–	–	(20.7)	(63.2)
Dividends paid on equity shares (see note 10)	–	–	(60.0)	(60.0)
Movement on cash flow hedges	(0.8)	–	–	–
Deferred tax on cash flow hedges	(0.3)	–	–	–
Actuarial loss on defined benefit pension scheme (net of related tax)	–	–	6.1	–
At 31 March 2013	**(59.4)**	**–**	**(963.5)**	**739.6**

21. Reconciliation of movements in Group shareholders' deficit

	2013 £m	2012 £m
Loss for the financial year	**(20.7)**	(20.5)
Dividend paid on equity shares (see note 10)	**(60.0)**	(130.0)
Cash flow hedges (net of deferred tax)	**(1.1)**	(27.9)
Actuarial gain/(loss) on defined benefit pension scheme (net of related tax)	**6.1**	(54.8)
Movement in shareholders' deficit	**(75.7)**	(233.2)
Opening shareholders' deficit	**(747.2)**	(514.0)
Closing shareholders' deficit	**(822.9)**	(747.2)

Notes to the financial statements for the year ended 31 March 2013 continued

22. Cash flow from operating activities

Reconciliation of operating profit to net cash inflow from operating activities:

	2013 £m	2012 £m
Continuing operations		
Operating profit	**225.3**	210.9
Depreciation charge	**113.7**	109.0
Goodwill amortisation	**9.5**	9.6
Amortisation of deferred income	**(3.6)**	(3.2)
Profit on disposal of fixed assets	**(0.8)**	(0.2)
(Increase)/decrease in debtors	**(1.9)**	10.8
Decrease in creditors	**(11.3)**	(27.6)
Movement in provisions	**2.1**	1.0
Total net cash inflow from operating activities	**333.0**	310.3

23. Analysis of net debt

	1 April 2012 £m	Cash flow £m	Non-cash changes £m	31 March 2013 £m
Bank overdraft	(4.9)	1.7	–	**(3.2)**
Debt due within one year:				
– Financial Instruments	(70.2)	–	(1.7)	**(71.9)**
Debt due after more than one year:				
– Bonds	(3,405.7)	–	(27.2)	**(3,432.9)**
– Bank loans	3.0	–	(0.7)	**2.3**
– Shareholders' loans	(533.6)	–	–	**(533.6)**
Onerous financial instruments	(150.2)	19.8	(8.0)	**(138.4)**
Other financial instruments	34.0	(0.7)	6.6	**39.9**
Short term deposits	83.0	(69.5)	–	**13.5**
	(4,044.6)	**(48.7)**	**(31.0)**	**(4,124.3)**

Short term deposits comprise short-term highly liquid investments with a maturity of three months or less.

Non-cash changes noted above represent fair value movements on financial instruments (see note 17) and interest incurred on index-linked bonds during the year which has not been paid and has been included within the carrying value of amounts borrowed.

24. Operating lease commitments

The Group has lease agreements for which the payments extend over a number of years.

	Other		Land and buildings	
	2013 £m	2012 £m	2013 £m	2012 £m
Annual commitments under non-cancellable operating leases expiring:				
Within one year	**–**	–	**–**	–
Within two to five years	**0.3**	–	**–**	–
After five years	**–**	–	**0.5**	0.5
	0.3	–	**0.5**	0.5

The Company has no operating lease commitments in either year.

25. Capital commitments

Capital projects contracted for by the Group but not provided in the financial statements amounted to £13.0m at 31 March 2013 (2012: £10.1m). The Company has no capital commitments at 31 March 2013 (2012: £nil).

26. Pension commitments

A significant proportion of the Group's employees are members of the Scotia Gas Networks Pension Scheme ('the Scheme'). The Scheme provides final salary defined benefits for employees who joined the Lattice Group Scheme prior to 31 March 2002. A defined contribution section was added to the Lattice Group Scheme from 1 April 2002 for employees joining the Lattice Group Scheme from that date. Employees of the Group who were previously members of the Lattice Group Scheme transferred to the Scotia Gas Networks Pension Scheme on 1 December 2005.

a) Defined benefit scheme

The Scheme is operated by the Group and is funded with assets held in separate trustee administered funds. It is subject to independent valuations at least every three years, on the basis of which the qualified actuary determines the rate of employers' contribution, which, together with the specified contributions payable by the employees and proceeds from the scheme's assets, are expected to be sufficient to fund the benefits payable under the scheme.

The latest full actuarial valuation was carried out as at 31 March 2012. In accordance with FRS 17, a limited actuarial review has been carried out by Hymans Robertson at 31 March 2013 using the projected unit method.

The following financial assumptions have been used:

As at 31 March

	2013	2012	2011	2010
Discount rate	**4.1% p.a.**	4.6% p.a.	5.5% p.a.	5.5% p.a.
Inflation assumption	**3.2% p.a.**	3.2% p.a.	3.5% p.a.	3.7% p.a.
Rate of increase of salaries	**4.7% p.a.**	4.7% p.a.	5.0% p.a.	5.2% p.a.
Rate of increase of pensions payment	**3.2% p.a.**	3.2% p.a.	3.5% p.a.	3.7% 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 expectancy in years for a member once they reach age 65 is as follows:

As at 31 March

	2013		2012		2011	
	Male	**Female**	Male	Female	Male	Female
Member currently aged 65	**25**	**26**	21	24	21	23
Member currently aged 45	**28**	**28**	25	28	24	27

Notes to the financial statements for the year ended 31 March 2013 continued

26. Pension commitments (continued)

The fair value of the assets in the scheme, the present value of the liabilities in the scheme and the expected rate of return were:

As at 31 March

	2013		2012		2011		2010		2009	
	Long term rate of return expected	**Value £m**	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m
Equities	**6.7%**	**192.5**	7.0%	258.3	7.8%	279.5	8.0%	308.3	7.7%	194.7
Government bonds	**3.0%**	**223.6**	3.3%	166.2	4.3%	99.2	4.5%	50.7	4.2%	63.6
Corporate bonds	**4.1%**	**318.5**	4.6%	166.2	5.5%	134.3	5.5%	63.1	6.7%	30.2
Property	**4.7%**	**41.7**	5.0%	40.3	5.3%	36.3	5.5%	20.2	5.2%	12.4
Cash	**1.1%**	**5.8**	1.9%	8.2	1.5%	9.9	1.1%	26.6	2.2%	17.2
Total market value of assets		**782.1**		639.2		559.2		468.9		318.1
Actuarial value of liabilities		**(862.9)**		(749.2)		(624.7)		(618.4)		(368.8)
Deficit in scheme		**(80.8)**		(110.0)		(65.5)		(149.5)		(50.7)
Related deferred tax asset		**18.7**		26.5		17.2		41.9		14.2
Net pension liability		**(62.1)**		(83.5)		(48.3)		(107.6)		(36.5)

The expected return on scheme assets represents the expected return of each major class of assets in which the scheme invests. Expected yield on fixed interest instruments is based on gross redemption yields at the balance sheet date. Expected return on equity interests reflect real rates of return experienced in the relevant markets.

Movement in fair value of scheme assets

	2013 £m	2012 £m
At 1 April	**639.2**	559.2
Expected return on scheme assets	**34.3**	36.6
Contributions from scheme members	**1.7**	1.7
Contributions from the Company	**44.2**	44.3
Actuarial gains	**74.7**	6.5
Benefits paid	**(12.0)**	(9.1)
As at 31 March	**782.1**	639.2

Movement in fair value of scheme liabilities

	2013 £m	2012 £m
At 1 April	**(749.2)**	(624.7)
Service cost	**(24.6)**	(21.6)
Interest cost	**(34.8)**	(34.7)
Contributions from scheme members	**(1.7)**	(1.7)
Actuarial losses	**(64.6)**	(75.6)
Benefits paid	**12.0**	9.1
At 31 March	**(862.9)**	(749.2)

The Group's contribution rate during the year was 37.3% of pensionable earnings. Additionally, the Group made special pension contributions to repair the deficit amounting to £23.5m. The expected contributions to be made in the year to 31 March 2014 are 37.3% of pensionable salary.

The actual gain on scheme assets was £109.0m (2012: £43.1m).

The cumulative amount of actuarial losses recognised in the statement of total recognised gains and losses since the adoption of FRS 17 is £127.3m (2012: £137.4m).

Analysis of the amounts recognised in the profit and loss account

	2013 £m	2012 £m
Amount charged to operating profit:		
Current service cost	**(24.6)**	(21.6)
Analysis of the amount credited to finance income:		
Expected return on pension scheme assets	**34.3**	36.6
Interest on pension scheme liabilities	**(34.8)**	(34.7)
Net finance (charge)/credit (see notes 6 and 7)	**(0.5)**	1.9
Net charge to the profit and loss account	**(25.1)**	(19.7)

Analysis of the amount recognised in the statement of total recognised gains and losses (STRGL)

	2013 £m	2012 £m
Actuarial gains on scheme assets	**74.7**	6.5
Actuarial losses on obligations	**(64.6)**	(75.6)
Deferred tax	**(4.0)**	14.3
Actuarial gains/(losses) recognised in the STRGL	**6.1**	(54.8)

History of experience gains and losses

	2013	2012	2011	2010	2009
Fair value of plan assets	**782.1**	639.2	559.2	468.9	318.1
Present value of defined benefit obligation	**(862.9)**	(749.2)	(624.7)	(618.4)	(368.8)
Deficit	**(80.8)**	(110.0)	(65.5)	(149.5)	(50.7)
Experience adjustments on scheme assets	**£74.7m**	£6.5m	(£3.3m)	£98.1m	(£82.8m)
– Percentage of scheme assets at year end	**9.6%**	1.0%	(0.6%)	20.9%	(26.0%)
Experience adjustments on scheme liabilities	**£44.6m**	£13.0m	£15.6m	(£20.7m)	–
– Percentage of the present value of scheme liabilities at year end	**5.2%**	1.7%	2.5%	(3.3%)	–
Total actuarial (losses)/gains on obligation	**(£64.6m)**	(£75.6m)	£45.7m	(£213.8m)	£8.1m
– Percentage of the present value of scheme liabilities at year end	**(7.5%)**	(10.1%)	7.3%	(34.6%)	2.2%

Movement in deficit during the year

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Deficit in scheme at start of year	**(110.0)**	(65.5)	(149.5)	(50.7)	–
Movement in year:					
– Current service costs	**(24.6)**	(21.6)	(22.7)	(14.2)	(13.5)
– Contributions	**44.2**	44.3	64.4	34.5	34.5
– Other finance (expense)/income	**(0.5)**	1.9	(0.1)	(3.4)	3.0
– Actuarial gain/(loss)	**10.1**	(69.1)	42.4	(115.7)	(74.7)
Deficit in scheme at end of year	**(80.8)**	(110.0)	(65.5)	(149.5)	(50.7)

b) Defined contribution schemes

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

	2013 £m	2012 £m
Amount charged in respect of defined contribution schemes	**2.6**	2.1

Notes to the financial statements for the year ended 31 March 2013 continued

27. Related parties

The Company is owned by a consortium consisting of Scottish and Southern Energy plc (50%), OTPPB Investments (UK) Limited (25%), which is owned by Ontario Teachers' Pension Plan Board and Borealis Infrastructure Europe (UK) Limited (25%), which is indirectly wholly owned by OMERS Administration Corporation.

It is the opinion of the Directors that the Group and Company have no single controlling party as the Company is controlled jointly by the consortium.

Transactions with shareholders

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

	Group	
	2013 £m	2012 £m
Shareholders' loans:		
SSE plc	**266.8**	266.8
Borealis (Luxembourg) SCA(1)	**133.4**	133.4
OTPPB Investments (UK) Limited	**133.4**	133.4
	533.6	533.6
Interest owed to shareholders:		
SSE plc	**11.2**	11.3
Borealis (Luxembourg) SCA(1)	**5.6**	5.7
OTPPB Investments (UK) Limited	**5.6**	5.7
	22.4	22.7
Other amounts owed to shareholders:		
SSE plc	**9.2**	6.3

(1) Borealis (Luxembourg) SCA is an affiliate of Borealis Infrastructure Europe (UK) Limited.

The aggregate interest expense charged to the profit and loss account in respect of shareholders' loans was £66.5m (2012: £66.7m). Interest accrues on the shareholders' loans at a fixed rate of 12.5% per annum and is payable semi-annually in arrears on 30 November and 31 May each year. The Company may, upon giving due notice, elect to pay some or all of the interest payable through the issuance of further loans to its shareholders.

Other than interest charges relating to shareholder loans, the following transactions took place during the year between the Group and the SSE plc group of companies (SSE).

	2013 £m	2012 £m
Sales of goods and services	**157.6**	154.3
Purchase of goods and services	**(57.0)**	(62.9)
Sale of tax losses	**10.4**	1.1

Sales of goods and services to SSE primarily represent gas transportation services. At 31 March 2013 an amount of £15.1m (2012: £13.9m) was owed by SSE in relation to these services and is included within trade debtors.

SSE provides services to the Group in the form of a management services agreement for corporate services. The Group also purchases certain items such as consumables stock, shrinkage gas and public liability insurance from SSE. Included within purchases of goods and services are direct costs in relation to tangible fixed asset and acquisitions projects incurred by SSE which have been recharged to the Group and capitalised. These costs amounted to £0.6m (2012: £0.6m).

During the year, the Group surrendered gross tax losses of £73.5m to SSE (2012: £36.6m) relating to the year ended 31 March 2011 for an aggregate cash consideration of £10.4m (2012: £1.1m).

Designed and produced by Tayburn

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Station Approach
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RH6 9HJ

Scotland Gas Networks
0845 070 1432

Southern Gas Networks
0845 070 1431

www.sgn.co.uk

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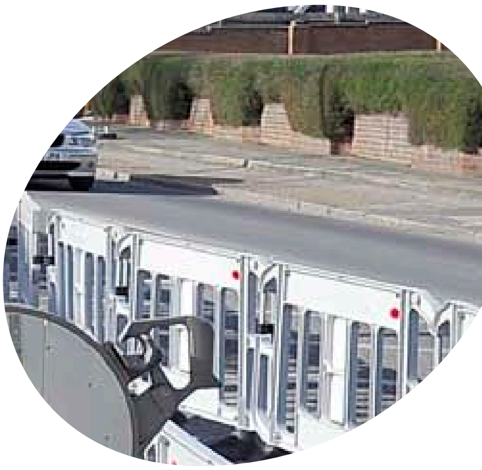
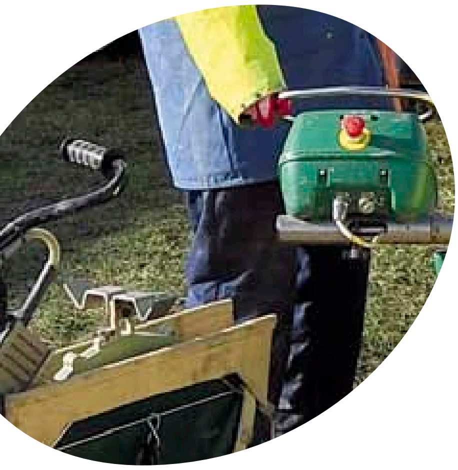


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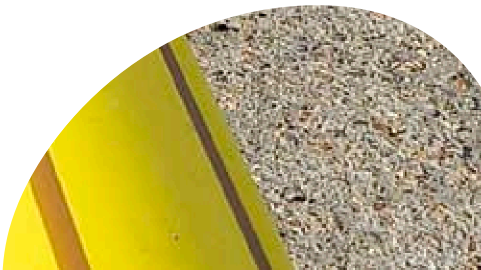

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Community Action Programme completed schemes

Chairman's introduction

In what continues to be a difficult and challenging economic environment, I am pleased to report Scotia Gas Networks has performed well during the year, in what is the penultimate year of the current price control period. Our turnover has increased to £929m and during the year we invested over £400m in the gas infrastructure across our regions.

On 27 April 2012 we submitted to our Regulator Ofgem, our final business plans for the eight year price control period commencing 2013. This plan, including a raft of input from our various stakeholders, sets out what we believe needs to be done to both drive the gas industry as well as our business forward, delivering value for money as well as secure gas supplies for all our customers through to 2021 and well beyond.

Our objectives over the coming year are simple. We want an acceptable outcome from this new regulatory price control, we want to continue our track record of delivering high standards of safety and customer service, and to deliver projects to green the gas. Your Board has a vision of a Company that cares. We care about our people, we care about our customers and we care about the gas industry we serve, determined to make sure it's an industry we can all take a pride in for decades to come.

Gregor Alexander
Chairman
20 July 2012

Scotia Gas Networks Limited (the 'Company') is a holding company which does not trade. This operating and financial review sets out the main trends and factors underlying the development and performance of the Company and its subsidiary undertakings (together the 'Group') during the year ended 31 March 2012 as well as those matters which are likely to affect its future development and performance.

The Directors, in preparing this operating and financial review, have sought to comply with the Accounting Standard Board's 2006 Reporting Statement: Operating and Financial Review as far as it applies to the circumstances of the Group.

Our business

Regulated by Ofgem, our Company owns and operates gas transportation and distribution networks in Scotland and the south and south-east of England. Our primary function is to provide a safe and secure supply of gas to our 5.8 million customers. This service includes the provision of a highly professional and robust emergency service to keep our customers and the general public safe, responding quickly and efficiently to calls.

Focused on our customers

Our principal objectives are:

- To deliver natural gas safely, reliably and efficiently across the gas distribution networks;
- To provide the highest standard of service to our customers;
- To deliver value to our shareholders.

Our overall financial objective is:

- To focus on operational efficiency and the efficient delivery of our capital and replacement expenditure programmes. Financial objectives are set to ensure regulatory targets are achieved or outperformed.

Customer focus
We were the first gas network company to publish a Customer Charter, which sets out clearly and concisely what our ‘customer promises’ are. This is available on our website.

Our values underpin everything we do

Safety
We all take responsibility for our own safety and for the safety of others

Performance
We strive for commercial success through efficiency, continuous improvement and innovation

People
We work and develop together with honest communication and respect

Customers
We listen to and understand our customers’ needs, deliver a quality service and keep our promises

Our world
We show through our actions that we care about the world and the communities around us

Gas networks’ regulation

All gas network companies are the subject of economic regulation through a five year Price Control set by Ofgem (to become eight years from 2013). The index-linked revenue earned comes from charges levied on network users, to cover costs and earn a return on regulated assets. Ofgem also places incentives on companies to be more efficient and innovative and to deliver an enhanced quality of service.

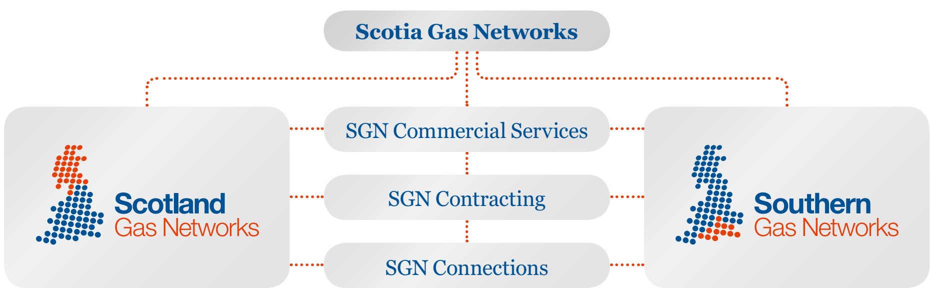
It also sets the framework for capital investment companies make in maintaining and upgrading the gas networks. The networks each have a Regulatory Asset Value (RAV), which represents:

- the price paid for them when they were privatised;
- plus allowed capital expenditure;
- less annual depreciation.

The RAV is indexed to the Retail Price Index.

Our structure

Scotia Gas Networks
The Company is owned by three shareholders – SSE plc (50%), Borealis Infrastructure Europe (UK) Limited (25%), which is indirectly wholly owned by OMERS Administration Corporation and OTPPB Investments (U.K.) Limited (25%), which is owned by Ontario Teachers’ Pension Plan Board.



Our operations throughout the UK

Our Scotland network distributes gas across all of Scotland to 75% of households, including remote areas via the Scottish Independent Undertakings (SIU) at Stornoway, Wick, Thurso, Oban and Campbeltown.

Our Southern 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, distributing gas to around 90% of households.

Our vision

To be the leading operator of gas networks in the UK

The scale of our business

Our Company owns and operates the regulated gas transportation networks in Scotland and the south and south-east of England which makes up two of eight regional gas distribution networks in the United Kingdom.

5.8 million

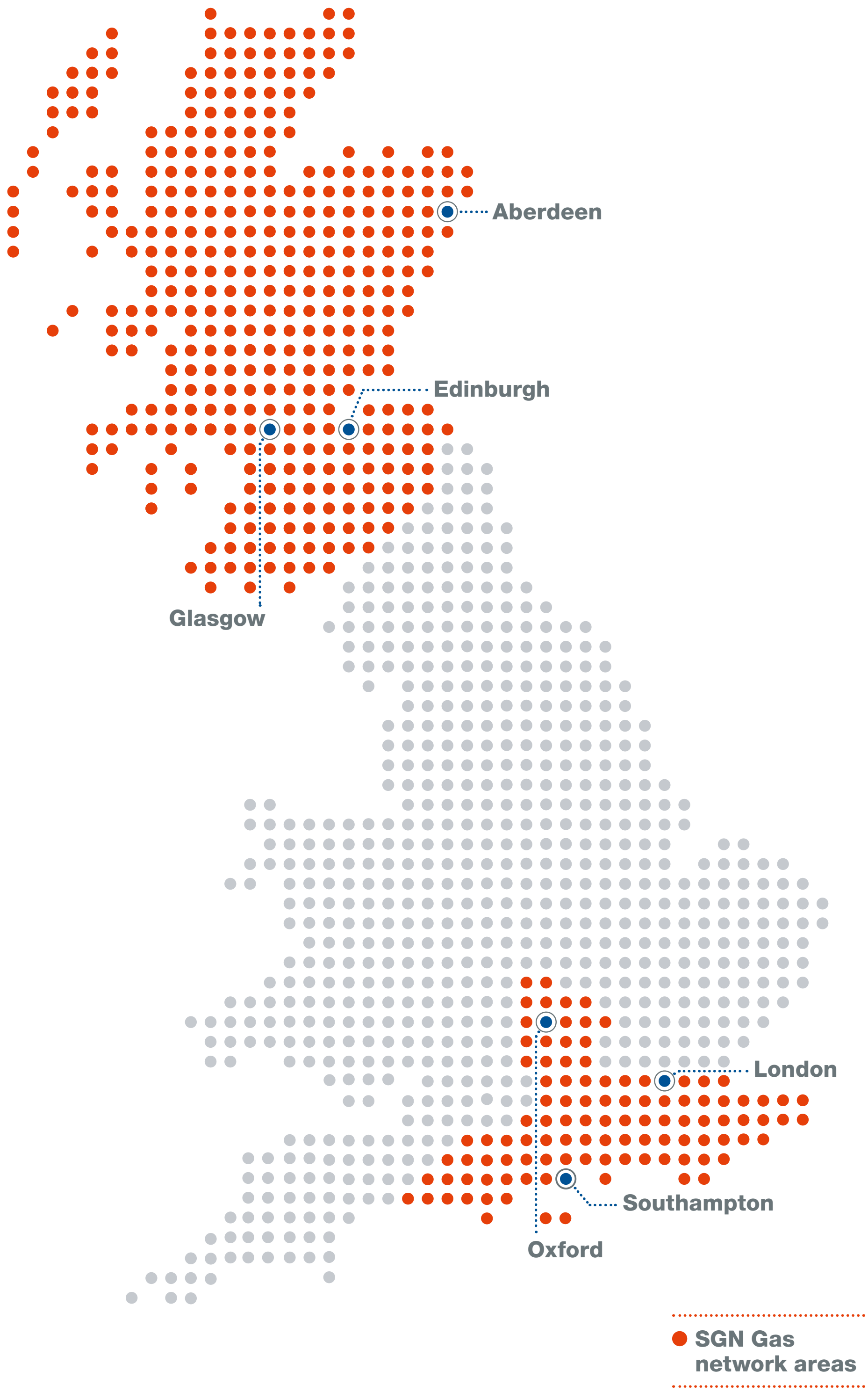
5.8 million domestic, commercial and industrial customers in the Southern region and throughout Scotland.

74,000km

74,000km of gas mains delivering natural gas throughout our regions.

3,819

We totalled 3,819 full-time employees as at 31 March 2012 (2011: 3,953).



Our people

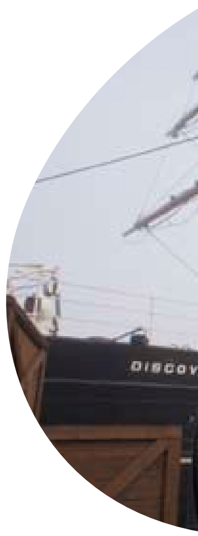
Our people are the life blood of our Company, which we recognise through one of our core Company values. Our ‘People’ value states we will work and develop together with honest communication and respect. To achieve this we maintain and develop a strong team of employees who have the technical knowledge required of participants in the gas industry and the professional and generic skills required to make our Company successful.

Young people

Our young people’s achievements gained recognition during the year including: Nicola Shand (pictured right) winning the IGEM/sbgi young person’s achievement award; Robbie Cake the UK Onshore Pipeline Association’s Young Person’s Paper Award; and Tamsin Morgan the IGEM young person’s paper competition.

Apprentices

We have had three great years of running our apprentice scheme, training to a very high standard the gas engineers of the future. In 2011/12 we had 106 apprentices in various stages of training.



Charity giving

Our ‘Into Action’ scheme is a matched-funding charity giving programme where we offer our people the opportunity to match funds they are raising for charity or community projects outside of work. Last year £60,000 was given back into the community in this way.

Kit for kids

Where our people play an active role in children's or youth sports teams, our Kit for Kids programme allows them to apply for new kit or equipment for that team. Last year this included kit for football, netball, hockey and even an ice hockey team.

Community Action Programme (CAP)

We give our people an extra day a year to team up and work on worthy community projects of their own choice. Last year 66 projects were completed with 421 of our people taking part.

Chief Executive Officer's review

Our business has come a long way since it was formed in June 2005. The strategic approach we have taken in the past four years of the current price control has seen our Company grow. Our regulatory value at 31 March 2012 exceeded £4.5bn. We have invested in our networks and also delivered key infrastructure projects safely. Indeed, the provision of a safe and secure gas supply to our 5.8 million customers remains our priority.

The SGN business model

Our business model is based on a local depot organisation. This ensures we are as close to the point of service as possible. We have a policy to in-source where practicable. Full control of our systems and managing down reliance on third party contracts is also a key to our success.

1. Depot network

- Better issue resolution
- Better use of resources
- Local interaction with customers

2. Insourcing contractors

- Operational control
- Cost reduction

3. Managed service agreements

- Discounts from volume purchasing
- Common stock lines

4. Systems approach

- Full control of gas pipeline assets

Introduction

Our primary function is the provision of a safe and secure gas supply to each of our 5.8 million customers through our two regional gas distribution networks. In addition we provide careers and employment opportunities for our 3,819 staff and, through our substantial network investment and replacement programme, for an additional 2,000 contract workers.

While the winter of 2010/11 was the worst on record, last winter was the mildest for a number of years which of course had a positive effect on our ability to respond to emergency calls and deliver our programme of capital, replacement and maintenance works. Despite the better weather, we still received over 260,000 emergency calls, each either requiring an immediate call from our engineers or additional repair work.

During the year we transported some 143.31Twh of gas through our networks, compared with 166.2Twh the previous year, this lower figure being mainly due to the milder winter weather. However the investment we make in our networks continued with capital and replacement works accounting for £404.3m in 2011/12 compared with £399.3m in 2010/11.

Projects

Gas has been delivered in one form or another to UK homes and businesses for around 200 years. Initially providing light, last century it became the heating and cooking fuel of choice for a majority of the UK population and this century we are seeking out new methods of 'greening' the gas to ensure its continued presence and use for many decades to come.

In 2010 we were the first company in the UK to break the traditional form of gas delivery over recent years, with a landmark project in Didcot, Oxfordshire producing and delivering the first biogas into the distribution network.

Following on from the success of Didcot, we now have a second biomethane project under construction in the eco-town of Poundbury, the Duchy of Cornwall owned estate near Dorchester, Dorset. Our £2.25m investment forms part of a joint venture with JV Energen with our contribution being to treat and enhance the biogas flowing from a new Anaerobic Digestion (AD) facility owned and operated by JV Energen. The bio-methane will then be delivered into our local gas distribution network with 800 cubic metres per hour of biogas flowing from the AD unit. The AD plant will be fuelled by 41,000 tonnes of locally secured feedstock including 5,000 tonnes of potato food waste, 24,500 tonnes of maize, 10,000 tonnes of one-year grass and 2,000 tonnes of chicken manure. Our involvement in this project places us in a leading position in the UK's development of biomethane delivery.

Our £21m project to replace three high pressure gas pipelines from the mainland to the Isle of Wight was completed and commissioned along with a new pressure reduction station on the island. Previously three pipes had been laid on the seabed of the Solent, but these were at the end of their useful life and were replaced with two 300mm (12") diameter steel pipelines installed under the seabed using the latest horizontal directional drilling technique.

£21m

An investment securing gas supplies to the Isle of Wight

The completed installation was marked by an opening ceremony in March 2012 when Isle of Wight MP Andrew Turner officially opened the pipeline and pressure reduction station. The project was important and will provide safe and secure gas supplies to 56,000 Isle of Wight homes and businesses for many years to come. In May 2011 the project team engineer was presented with a gas industry award to recognise her work and that of her team in bringing the project to fruition.

Gas Control

In June 2011 our new national gas control system went live after a number of years in development. Managing our two gas network areas for the first time from our central control, the hand-over from National Grid systems is a significant milestone, achieving for the first time, true separation of the UK gas distribution industry. The project has addressed a longstanding and acknowledged challenge for UK gas infrastructure and lays the foundations for future innovation and efficiencies.

Since it went live, our systems have been working well, providing our network engineers a firm foundation from which to maximise the efficient use of our assets. The system also controls the storage of gas at high pressure within the pipes themselves as well as conventional storage facilities. These systems are known as SCADA (Supervisory Control and Data Acquisition) and work in conjunction with other business applications, which allow gas demand forecasting, modelling and balancing ensuring sufficient gas is available in the right locations to meet our customers' needs 24/7.

Operations

Emergency and repair

Our engineers respond to calls from members of the public reporting suspected gas leaks. We do this 24 hours a day, 365 days a year, regardless from whom they buy their gas. We attend all uncontrolled gas escapes within one hour and all controlled gas escapes within two hours. A controlled gas escape is where the person reporting can confirm the gas emergency control valve has been turned off and the smell of gas has gone. An uncontrolled gas escape covers all other circumstances.

During the year our engineers attended 98.7% of uncontrolled gas escapes within one hour, (2011: 97.2%) exceeding the 97% Ofgem target. We were pleased to again beat the target and demonstrate to our stakeholders the extreme priority we assign to keeping members of the public safe. This was an excellent performance by our operations teams both in our Southern and Scotland network areas.

98.7%

Beating the standards for attending emergency calls is essential in retaining the confidence of the general public

In February 2012 we started a trial in our Edinburgh depot where our own customer service staff take the incoming calls direct from customers ringing the 0800 111 999 National Gas Emergency Number. Since formation in 2005, we and the other gas distribution companies have paid National Grid to take these calls on our behalf. Our trial, the first to break away from this traditional approach, has provided some valuable information to assess the nature of the calls and allow them to be prioritised. We are currently looking to extend the trial further in our Southern area during 2012/13.

During the year we have had to deal with a number of incidents in both our Scotland and Southern areas when burst water mains have damaged our gas mains, causing large quantities of water to enter the main and cut off gas supplies, often to many hundreds of customers at a time. In each of these occasions our engineering teams responded magnificently, with good support from ancillary functions to have gas supplies restored within very short timescales.

Chief Executive Officer's review
continued

In September 2011 we launched our depot pilot scheme in two of our 15 operations depots. Aldershot and Glasgow were selected with the aim of piloting brand new objectives, introducing innovations and new working methods, thereby improving efficiency and providing a model for our other depots. The pilot scheme came to a close in March 2012. Key successes included the development of a more flexible work-force, where targeted training and the up-skilling of First Call Operatives (FCOs) opened the way to personal development and the ability to complete a mixture of jobs. New key performance indicators provided improvements in local ownership and accountability across all areas. A focus on customer service, with commitment based management (CBM) training and improved communications has seen our Customer Satisfaction Scores (CSAT) increase to 'nines' out of ten, proving we can consistently deliver a high level of service for our customers. We are more engaged and aware of the behaviour of our teams when carrying out work, ensuring they are positive and focused on doing the best job they can. The plan is to roll-out this model to our 13 remaining operations depots in the first half of 2012/13.

Having additional work available for our FCOs engaged on emergency and repair work is essential to retain productivity and efficiency during the lighter work periods, such as the summer months. Without this and without a fully funded emergency and repair function from the regulator, the cost of the large workforce necessary to cover the winter emergency periods is difficult to sustain. Our primary source of work is domestic metering contracts with National Grid and other gas suppliers.

Mains replacement

In agreement with Ofgem and the Health and Safety Executive (HSE), we have an extensive programme in both our networks to replace all iron gas pipes located within 30 metres of any property. This includes the replacement of the individual services connecting the property to the network and we use a mixture of contract and direct labour on this activity.

In Scotland the output of our direct labour force increased by 15% on the corresponding period last year and we exceeded our target by replacing 324km of old pipe with modern polyethylene pipe. In our Southern area we also exceeded our original target of 766km by achieving a total of 876km. This additional target was set because of the restrictions the Olympic Games will impose, limiting opportunities across south London to carry out replacement works during 2012. In total across both our networks, we replaced 1,202km of old pipe (1,102km: 2010/11), increasing our investment in gas mains replacement activities to £260.6m (£256m: 2010/11).

In anticipating the embargo being imposed on and around all nominated road networks, we have contributed to the efforts of all utility companies to mitigate the effects our essential works will have in and around London during the Olympic and Paralympics games.

Pipeline contracts

During the year we retained three, seven-year contracts worth over £15m to maintain and provide emergency cover to the mainstream and energy critical high pressure pipelines and compressor stations transporting gas to Eire and to Northern Ireland. Two of the contracts were with BGE (UK) a subsidiary of Bord Gais Eireann and the other with Mutual Energy Ltd in Northern Ireland. The original contracts commenced in 1996/7 when the pipelines were commissioned.

Safety

Injury performance

Our overriding goal is to distribute gas safely and reliably to our 5.8 million customers and to ensure a safe workplace for our workforce, with everyone striving for the elimination of all injuries, however minor. This year we reduced our lost time injury rate to 0.04 per 100,000 hours worked (0.05: 2010/11).

During the year we received the 2011 Overall Safety Achievement Award by the Gas Industry Safety Group (GISG), for our work in further improving safety across our industry.

Safety initiatives

Third party damage

Damage to our gas network caused by third parties results in supply interruptions, creates inconvenience to our customers, road users, and above all risks the well-being of those causing the damage. It also has the secondary effect of disrupting other planned activities by diverting valuable working time from other projects aimed at ensuring a safe and secure gas network. A large proportion of damage and interference to the gas network has been found to take place within the perimeter of domestic premises, through gardening, the building of extensions and conservatories and the erection of fences.

During the year we took positive steps to counter this and introduced a number of initiatives to reduce the risk of harm to the public. These included:

1. An audit of our Plant Protection Process which enhanced the efficiency of our Plant Protection Officers;
2. A 'Response to Repeat Offenders' process was developed, where local managers identify potential culprits and intervene at an early stage;
3. Liaison with utility companies and contractors to provide coaching and increase awareness of the dangers to their staff; and
4. Information packs to assist our teams and to help the general public.

Safety centres

During the year we engaged the 'in-footprint' members of Safety Centres UK, a network of facilities providing Safety learning opportunities for groups of 11-year-old schoolchildren.

SGN Innovation
Isle of Wight cross-Solent under-sea pipeline drilling

Engineers have drilled two tunnels up to 30 metres beneath the Solent seabed to lay a new 3.8km gas main from the mainland coastline at Lepe on the edge of the New Forest to Gurnard near Cowes, in what is believed to be the longest drilling of its kind.

The cross-Solent gas pipeline replaces the three old lines, installed in 1966, from the mainland to Egypt Point and took 18 months to construct following four years of planning, surveys, trials and consultation with relevant authorities.

The complex directional drilling was completed using specialised hydraulic machines operated from land. Two separate tunnels were drilled beneath the seabed from both sides of the Solent with the drill-heads meeting in the middle before the new gas mains were pulled through and the supply connected.

Gas is now flowing through the new dual pipeline, with the connection to the existing network providing a secure and continuous supply for the island's 56,000 gas customers.

56,000

Isle of Wight customers now have a more secure and continuous supply of gas.

Watch the video on youtube:
http://youtu.be/lwbcxq6Hw2A

Chief Executive Officer's review continued

Our aim is to continue working with these centres beyond our initial support, developing further the facilities at each centre to advise and inform the children of danger, not only from carbon monoxide, but more generally from our gas operations.

Each centre is a separately registered charity and the funding we provide contributes to the continuing safety of the children in their area. Our specific support has helped provide training to some 13,000 children in the Bournemouth area, 4,000 in Oxfordshire, 21,000 in and around Milton Keynes and around 10,000 in Edinburgh. We are planning to develop this further through the generation of a sustainable network of local support provided mainly by people from within our own depot operations structure.

Carbon Monoxide (CO)

We were pleased to be recognised by the All Party Parliamentary Gas Safety Group as having made a significant contribution to its deliberations in respect of CO exposure across the general population. In their final report they case-studied the issuing of personal air monitors (PAMs) to our field based front-line staff, as a demonstration of our commitment to CO safety and as a direct response to the risks. They quoted: 'This initiative demonstrates not only protection of the employee but those they visit, whether on emergency or other duties, including metering and service replacement work.'

Information exchange

In 2011 we became a member of the National Underground Assets Group (NUAG). This body includes all the major organisations involved in street works activities and aims to improve the way Utilities and Highway Authorities record and share their data on buried assets.

We are one of the sponsors of the NUAG London Project and, as well as providing financial support, are a member of the project's Customer Advisory Group (CAG). Along with the other CAG members, we have been trialling the new service before it is rolled out to other Local Authorities and utilities within the M25. We are pleased to be actively involved in this major collaborative effort that will significantly contribute to more effective planning and safer execution of street works activities.

Board responsibility

Our Board has a Safety, Health and Environmental Advisory committee responsible for monitoring our health and safety performance, ensuring adherence to the health and safety policy and which provides the Board with reports on any key issues. Further details on the committee are set out on page 29 in our corporate governance statements.

Gas connections and assisted connections

Over the course of 2011/12 we connected 19,456 new properties to the gas network. This was slightly down on the previous year (2011: 21,167), largely due to the economic downturn and reduced activity in the UK new housing market. We do not expect significant change during 2012/13.

We are also committed to making as affordable as possible new connections to homes that are not yet on mains gas, and run an Assisted Connections scheme under which 5,096 properties were connected to our networks during 2011/12.

Building on work last year with Edinburgh District Council, we are pleased to continue our support for small scale District Heat Schemes. Although these projects do not qualify the Company for any allowances under the existing fuel poor scheme, we recognise the significant difference they can make to fuel poverty and energy efficiency. The support we provide comes from our system extension fund which accumulates from fuel switching allowances from our supplier partner.

612

Suggestions made into our IGNITE staff suggestion scheme.

SGN Innovation
Green the gas – Poundbury

Building on our joint venture (JV) success at Didcot we are involved in a further JV project that will supply biomethane to the Eco-Town of Poundbury in the Duchy of Cornwall owned estate near Dorchester in Dorset.

Whereas Didcot used water wash technology to clean the biogas, strict planning constraints required an even more innovative approach with membrane separation being used for cleaning at Poundbury. The anaerobic digester is completed and takes 41,000 tonnes per annum of locally secured feedstock including 5,000 tonnes of potato food waste, 24,500 tonnes of maize, 10,000 tonnes of one-year grass and 2,000 tonnes of chicken manure.

Full commissioning of the bioplant is underway and when complete both it and the anaerobic digester will add two vital pieces to the Poundbury jigsaw.

Chief Executive Officer's review
continued

Aberdeen City Council's Affordable Warmth Scheme is aimed at city owner-occupiers on low fixed-incomes, who have little or no capital, whose assets are tied-up in their house and who are in fuel poverty. Currently, around 200 home owners are helped by a Scottish Government £250,000 revolving loan fund, but each year, a small number of householders fall outside the criteria for the Government scheme. Our assistance has enabled the Council to provide grants under the Affordable Warmth Scheme to help these householders make their homes more fuel-efficient. It also identifies households without a gas supply who may qualify for our 'Assisted Connections' scheme.

Innovation

Discretionary Reward Scheme

For the third time in the three years the scheme has been running, we were delighted to come top of Ofgem's Discretionary Rewards Scheme (DRS). The regulator makes up to £4m available to all the distribution networks to recognise initiatives and innovation across three specific areas and rewards them accordingly. In 2011 we were the top gas distribution company, and were awarded £1.3m (2010: £1.1m).

The award comprised £400,000 for mitigating environmental impact, £400,000 for fuel poverty alleviation and £500,000 for safety initiatives and takes the total amount we have secured from Ofgem's scheme to £2.95m over three years.

Other Innovations

One of our key Company objectives is to be at the forefront of innovation and development in the gas industry, not only to improve our own efficiency and methods of working, but to improve industry safety, working practices and also to ensure a future for the UK's gas networks for many years to come.

There are a number of innovative areas and projects we are progressing both alone and with partners. One such area of interest is Hydrogen where we are looking to partner a number of leading players on a UK project that would involve using wind power and, through electrolysis, create hydrogen to blend with natural gas and deliver in to our network. This technology is at an early stage in development but one we want to be involved with as it develops into possible future commercial use. Another innovation we are looking at is new robot technology from the USA called CISBOT (Cast Iron Sealing roBOT). This is the development of a new method of making repairs to cast iron joints from the inside. Already in use in the USA, this innovation could be very beneficial for the UK gas distribution industry.

On gas storage we are also progressing ANG (Absorbed Natural Gas) storage. This is using carbon fibre to absorb natural gas in the network up to 7bar. Again, this is at the early stages of development but has potential to be a replacement for gas storage or reinforcement in the future.

Finally, another innovation we are investigating is Cured In-Place Polymer (CIPP), which is more commonly known as spray-lining. Here we are leading a collaborative project with the other gas network companies and the Water Research Council to see what is possible in terms of extending the life of our assets.

Customer service

Customer Charter

During the year we were the first gas distribution company to publish a Customer Charter. Our Charter is designed to inform our customers what we will do for them and allows us to make solid promises on matters we know are important to them. It is designed to cover all the areas where customers tell us we could improve in our Ofgem customer satisfaction survey feedback and our customer enquiries feedback. It also provides an opportunity to further promote safety advice, increase carbon monoxide awareness and gather information on vulnerable customers.

Measure of success

We measure success in customer service in several ways:

- Ofgem carries out independent customer satisfaction surveys every quarter and has seen consistent improvements. Our customer satisfaction results show our connections scores increased in both Scotland Gas Networks, from 7.66 to 8.03 and in Southern Gas Networks, from 7.24 to 7.47. 8.03 is the highest ever recorded connection score for any network.
- We also monitor customer complaints and during 2011/12 we have seen a substantial reduction in our complaints compared with last year.
- We carry out weekly customer satisfaction telephone surveys to track our performance and use the feedback to hold weekly improvement meetings with our senior managers and staff. For example, in connections, our depots have increased their average scores from 7.56 to 8.52, well above the average for other networks.

Environment

During the last four years we implemented a campaign known as '5O5' to realise our strategic objective to enhance our environment and sustainability performance. 5O5 has involved setting five objectives to reduce our most significant environmental impacts over a period of five years. It has been embraced by our employees at all levels and already delivered significant results.

SGN Innovation
Leak detection

Magnetometer
By measuring the strength of magnetic fields this instrument can probe the ground and, because it can identify metal of different thickness, can accurately pinpoint joint locations on metallic mains. Originally used by British troops in Afghanistan to detect roadside mines, the tool has been adapted for use in the UK gas industry.

The device is now assisting our engineers locate a leaking joint on a pipe run more quickly, reducing the number of excavations required by as much as 20%. This brings environmental improvements and minimises disruption to the general public. It is now in wide use across our Company.

Gas in ducts equipment
This is designed to pinpoint gas escapes that are diffusing through underground ducts belonging to other utilities. It speeds up the repair activity by providing an accurate measurement of the source of ingress, reducing the number of excavations and minimising disruption to the general public.

19,456

New gas connections to homes and businesses in 2011/12.

Chief Executive Officer's review
continued

The 5O5 Campaign
The name 5O5 means 'Five Objectives over Five Years'. These objectives are:

- Reduce our natural gas emissions;
- Reduce our carbon emissions;
- Reduce our impact on landfill;
- Increase our energy efficiency; and
- Reduce any wastage of materials.

With these objectives we aim to go beyond just complying with legislation. We are committed to the protection and enhancement of the environment and will always seek out new methods and practices to minimise the environmental impact of our work. Our achievements are highlighted on the next page.

Environmental recognition
During the year we were awarded a Green Apple Environment Award by The Green Organisation; an independent group dedicated to recognising and promoting environmental best practice. This prestigious award has been given for our waste management back-loading strategy in our Southern network that avoids our depot waste going to landfill. This demonstration of our commitment to our environment will be reinforced by the implementation of a similar process in Scotland.

We were awarded BS 25999, the British Standard for Business Continuity Management which recognises good business planning, becoming one of the first utilities to be recommended for the certification. In addition we renewed our ISO 14001 certification for our environmental management system which involved close inspection of operational sites, depots, offices and several operational teams and contractors across both our network areas.

In addition the award of the Carbon Trust Standard in 2011 reflected our hard work in continually reducing our carbon emissions year-on-year. The certification is seen as a definitive stamp of approval for organisations that have genuinely demonstrated they have reduced their carbon footprint. Electricity and gas usage in our premises, diesel consumption in our vehicles and plant and natural gas emissions from our network were all measured and were shown to have reduced over the certification period.

Regulation
Our next price control review with Ofgem is in progress now. This will set revenues for an eight year period starting 1 April 2013. This review is based on the new RIIO methodology, which builds on the existing RPI-X framework and provides more emphasis on outputs, incentives and innovation, underpinned by extensive stakeholder engagement. After the review process is complete, Ofgem is expected to release final price control proposals in December 2012.

We will continue to strive to build on our excellent track record of creating shareholder value. Our key priorities for 2013 and beyond are to:

- Deliver a safe and secure gas supply to customers;
- Secure an acceptable settlement in the next price control review, ensuring stable returns;
- Deliver to time and budget the current price control targets; and
- Continue to improve our green credentials and reduce greenhouse gas emissions.

John Morea
Chief Executive Officer
20 July 2012

9.3%

Natural gas emissions reduced through environmental controls.

SGN Environmental Achievements

We are in the fourth year of our 5O5 environmental programme. With five targets in five years we have:

- Reduced our natural gas emissions by 9.3%, saving 430,000 tonnes of CO_2e;
- Reduced carbon emissions from our commercial and company car fleets saving around 5,800 tonnes of CO_2e;
- 600,000 tonnes of excavated spoil has been converted into material that can be reused – avoiding the use of 170,000 tonnes of virgin aggregate;
- Reduced our depot and office waste going to landfill, diverting more than 2,100 tonnes to recyclers; and
- Improved video conferencing facilities within our Company with an additional 1,050 video conferences – saving a significant amount of travel emissions, travel time and costs.

Winner of a 2011 Green Apple environmental award.

Key performance indicators

We measure how successful we are in achieving our objectives through the use of quantitative assessments and, where these are less relevant, through the use of qualitative assessments. Our principal key performance indicators (KPIs), which are used to assess whether principal operating objectives have been achieved are set out below:

Financial

EBITDA

£329.5m

2012	£329.5m
2011	£227.5m
2010	£240.7m

Earnings before interest, tax, depreciation and goodwill amortisation ('EBITDA') is a non-statutory measure and is calculated by adding back goodwill amortisation and depreciation to operating profit.

Adjusted EBITDA

£590.1m

2012	£590.1m
2011	£483.5m
2010	£485.4m

EBITDA excluding replacement expenditure ('Adjusted EBITDA') is calculated by adding back goodwill amortisation, depreciation and 100% of replacement expenditure to operating profit.

Capital expenditure

£143.7m

2012	£143.7m
2011	£143.1m
2010	£167.9m

Additions to tangible fixed assets include new distribution mains and storage, new connections to existing mains, new governors and meters, and new investment in IT, land and buildings, vehicles and plant.

Replacement expenditure

£260.6m

2012	£260.6m
2011	£256.0m
2010	£244.7m

Replacement expenditure is written off to the profit and loss account as it is incurred under UK GAAP. It represents the cost of renewing certain sections of gas network with modern polyethylene pipes to improve future safety and reliability. The sections replaced include mains – the pipelines forming the backbone of the distribution infrastructure – and smaller diameter service pipes, which connect customers to mains.

Debt to RAV ratio

63.7%

2012	63.7%
2011	67.3%
2010	67.0%

The Group's net debt to Regulatory Asset Value ('RAV') ratio. RAV is defined as Ofgem Regulatory Asset Value of the Southern and Scotland networks plus additions in excess of current allowances expected to be recovered in future periods. Debt for the purposes of the Debt to RAV ratio excludes shareholders' loans and liabilities arising from derivative financial instruments. The percentages stated are as at 31 March.

Operational

Employee lost time incidents

0.04

2012	0.04
2011	0.05
2010	0.06

This is defined as the number of incidents per 100,000 hours worked resulting in employees taking time off work. This is one of the key operational metrics which is monitored on a consistent basis. The numbers of incidents show an improvement over the last three years. Safety is one of our core Company values and monitored closely by the Board.

Customer satisfaction: planned interruptions

8.0

2012	8.0
2011	7.9
2010	8.0

Results from customer satisfaction surveys (10 = very satisfied). These are based on customer satisfaction survey reports obtained for the nine month period ended 31 December 2011 for Southern Gas Networks and Scotland Gas Networks. Planned interruptions on our replacement, capital or routine maintenance works, are where timing can be predicted and the customer has been notified in advance.

Customer satisfaction: unplanned interruptions

8.6

2012	8.6
2011	8.4
2010	8.3

These are present results from customer satisfaction surveys undertaken (10 = very satisfied). These are based on customer satisfaction survey reports obtained for the nine month period ended 31 December 2011 for Southern Gas Networks and Scotland Gas Networks. Unplanned interruptions arise through leakage or other emergencies such as damage to the infrastructure (e.g. by burst water mains).

Escapes attendance

98.7%

2012	98.7%
2011	97.2%
2010	97.9%

This represents the proportion of uncontrolled gas escapes attended in one hour (target 97%). Uncontrolled gas escapes are defined as those where the smell of gas persists and where the gas supply is still 'on' at the time the customer calls.

Financial review

We have set out below our financial review for the year ended 31 March 2012. The results for the period are reported under UK GAAP including FRS 25, 26 and FRS 29. The comparative figures presented are for the year ended 31 March 2011, as reported in the audited financial statements, unless otherwise stated:

Key financial highlights

	2012 £m	2011 £m	2010 £m
Turnover	928.7	802.0	783.4
Adjusted EBITDA	590.1	483.5	485.4
Net finance costs	(231.5)	(234.8)	(186.6)
Loss for the financial year	(20.5)	(102.2)	(66.9)
Replacement expenditure	260.6	256.0	244.7
Capital expenditure	143.7	143.1	167.9
Long term debt*	3,402.7	3,159.8	2,776.1
Regulated Asset Value	4,540	4,270	3,930

*excludes shareholder loans

Regulated asset value and total network investment

In considering financial performance, we use EBITDA and Adjusted EBITDA. EBITDA is calculated by adding back goodwill amortisation and depreciation, which are non-cash costs, to operating profit. Adjusted EBITDA is calculated by adding replacement expenditure to EBITDA.

Replacement expenditure, which, under UK GAAP, is written off to the profit and loss account as it is incurred, improves the future safety and reliability of our networks through the replacement of older gas pipes with modern pipes. Ofgem treats 50% of projected replacement expenditure as recoverable during the year and 50% as recoverable over future years. Accordingly, we believe the use of these adjusted measures best illustrates the underlying performance of our business.

Financial performance

Turnover for the year has increased from £802.0m to £928.7m in line with the regulatory settlement, investment levels and inflation. The majority of turnover was earned from charges for the provision of gas transportation capacity to various gas shippers as well as revenue based upon gas volumes transported in the year.

Adjusted EBITDA for the year increased from £483.5m to £590.1m reflecting the increase in revenues.

Network investment

Investment in the distribution network is a key priority to maintain safety and integrity. The total network replacement and capital expenditure was £404m in the year, continuing the trend from previous years. As a result of this investment, the Regulatory Asset Value increased by 6% in the year from £4.27bn to £4.54bn.

Replacement expenditure

We renew the old iron pipes with modern polyethylene pipes to improve the safety of the existing network. Expenditure on replacement of iron pipes increased to £260.6m from £256.0m in the previous year, as investment in our network to improve safety continues to be a key priority. In addition, some work was advanced ahead of the forthcoming London Olympics in July 2012.

During the year we replaced 1,202 kilometres of metallic pipe, an increase of 9% from 2011 (1,102 kilometres).

During the year we also commissioned the Isle of Wight pipeline replacement project which was completed at a cost of £21m. The project involved replacing three high pressure gas pipelines from the mainland to the Isle of Wight with two new pipelines under the seabed and installation of a new pressure reduction station on the island.

Principal risks and uncertainties

As well as the opportunities the Group has to grow and develop the business, certain risks and uncertainties are faced in achieving its objectives. The principal risks and uncertainties identified are as follows:

- Regulatory price control treatments of certain costs and allowed regulatory rate of return on investments;
- Changes in laws or regulation affecting the business, for example environmental or health and safety law or regulation;
- Breaches of laws or regulation affecting the business, or breaches of licence conditions;
- Credit market conditions, including the availability and cost of financing and re-financing;
- Failure of the network or other critical non-network operations;
- Pension scheme funding requirements; and
- Changes in tax allowances or rates.

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 28 to 30.

Financial review
continued

The project was completed and commissioned as planned ensuring continuous supply of gas to 56,000 customers on the island.

Capital expenditure
Total capital expenditure remained in line with prior year at £143.7m (2011: £143.1m). Capital expenditure is incurred to ensure the networks continue to operate at minimum agreed pressures and sufficient storage capacity is available to meet instances of peak demand. New connections or increases in capacity to the networks also necessitate capital expenditure.

We commissioned several capacity driven pipeline projects in Scotland following the recent interruption reforms. These will ensure uninterruptible gas supply to our customers.

Treasury policies and capital structure
Financing consists of a mixture of equity, loans from shareholders and long-term debt. The investments and operations are mainly financed by long-term bonds and bank borrowings. Our 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 page 26.

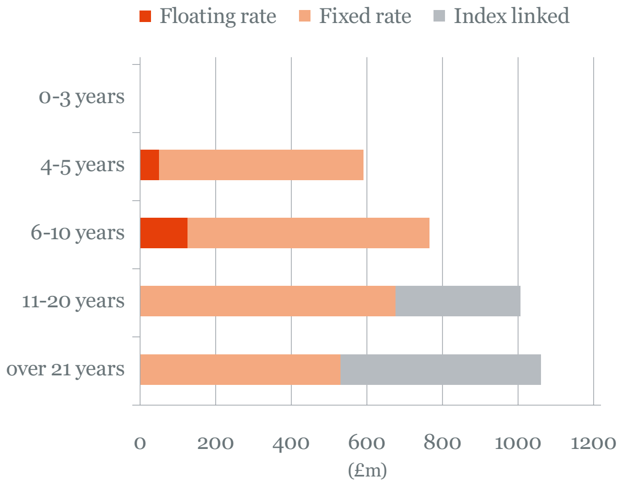
As a matter of policy, a minimum of 75% of debt excluding shareholders' loans is maintained at either fixed rates of interest or index-linked. This policy is kept under review from time to time. Interest rate swaps are used where necessary, in order to achieve the desired profile.

We manage the maturities of debt and facilities to ensure no significant refinancing is required in any one period. By avoiding significant financing pressure in any one period we can access competitively priced debt. In addition, the debt interest outflows are managed to ensure a competitive interest risk profile to allow us to meet our financing objective of at least 75% fixed rate or index linked interest.

At 31 March 2012, total debt (before issue costs), excluding shareholders' loans and liabilities arising from derivative financial instruments, amounted to £3,418.3m (2011: £3,172.4m) and the debt to RAV ratio was 63.7%* (2011: 67.3%). Of the total long-term borrowings at 31 March 2012, excluding shareholders' loans and after taking into account the effect of interest rate swaps, 87.2% were at either fixed rates of interest or were index-linked (2011: 80.8%).

*this represents the weighted average of the individual Southern and Scotland network ratios.

Long-term debt maturity profile



We manage the maturities of debt and facilities to ensure no significant refinancing is required in any one period.

The net interest costs for the year were £231.5m (2011: £234.8m). Interest costs before mark to market movements on derivatives increased to £240.0m from £228.3m in prior year mainly due to increase in debt. The net mark to market gain for the year ended 31 March 2012 was £9m, compared with a loss of £4.7m in 2011.

At 31 March 2012, there was a net derivative liability of £36.2m before tax, on the balance sheet (2011: £32.5m). Appropriate interest rate swap contracts are used to achieve the target interest risk profile. FRS 29 requires these swaps to be valued at 'fair value'. This is calculated using market based interest rate information at the year end. The increase in the liability mainly represents the effect of the decline in gilt yields in the year.

In line with the gearing objectives, we believe in maintaining a strong balance sheet and an investment grade credit rating. Our current credit ratings are:

- 'BBB+' with stable outlook (Fitch ratings);
- 'BBB' with stable outlook (Standard & Poors); and
- 'Baa1' with stable outlook (Moody's).

Liquidity and cash flows

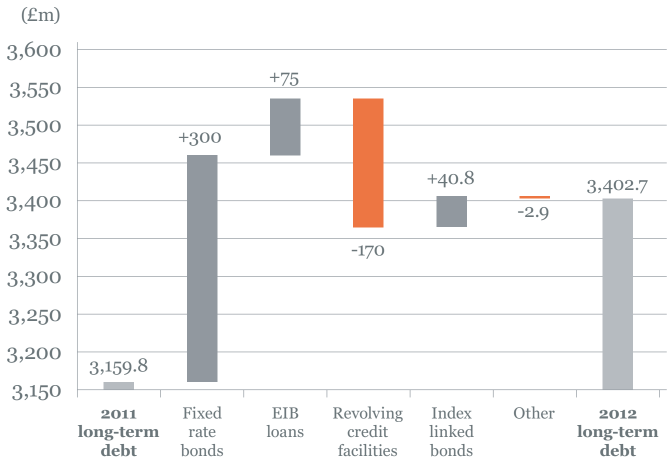
Liquidity is maintained through a mixture of long-term borrowings and short-term liquid funds in order that there are sufficient funds available for our current and planned operations. Committed facilities are in place in order to provide funding for future capital and replacement expenditure, as well as to provide sufficient available facilities to meet our seasonal working capital requirements.

During the year, a refinancing exercise was undertaken ahead of the new price control review in 2013. We issued a £300m 12 year bond in September 2012 in an oversubscribed placing. The bond carries a fixed interest rate of 4.875% and is redeemable at par on 5 October 2023. In addition, in December 2011, we renewed our revolving credit facilities for a period of five years to December 2016. As at 31 March 2012, the committed undrawn revolving credit facility amounted to £280m (2011: £110.0m).

We secured loan financing from the European Investment Bank in September 2010 of £250.0m. A total of £75m was drawn in the year and the facility is now fully utilised.

Net cash inflow from operating activities for the year amounted to £310.3m (2011: £192.7m), the increase is primarily due to the level of transportation revenues compared with last year.

Movement in long-term debt



During the year, a refinancing exercise was undertaken ahead of the new price control review in 2013.

Financial review
continued

The net cash outflow from returns on investments and servicing of finance was £196.7m (2011: £193.4m) with the increase being attributable to the issue of new debt. Net investment cash outflow for the year was £125.2m (2011: £121.3m) reflecting an increase in capital expenditure during the year due to the ongoing capital improvement programme. After taking into account movements in short-term deposits and financing items, overdrafts decreased by £2.4m in the year (2011: increase of £0.8m).

Revaluation of fixed asset investments and dividends
The accounting policy for investments in the distribution network subsidiaries in the holding company balance sheet has changed from an historical cost basis to a valuation basis permitted under the alternative valuation rules in the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. This resulted in a credit to the revaluation reserve of £1,080m at 16 June 2011. In accordance with section 551 of the Companies Act 2006, the Directors approved a scheme to allot 1,080m bonus shares with a nominal value of £1 out of the revaluation reserve created by the revaluation of fixed asset investments. At the same time the Directors approved a share capital reduction to cancel the rights of those shares and reduce the share capital by £1,080m (1,080m shares of £1 each). This is further detailed in notes 13 and 20.

During the year we paid dividends of £130m (2011: £60m).

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

In accordance with FRS 17 (Retirement benefits), our balance sheet accounts for any pension asset or liability. The net pension liability as at 31 March 2012 was £83.5m (2011: £48.3m).

Following the valuation carried out by the scheme's actuary as at 31 March 2009, with effect from 1 April 2010, annual special pension contributions were increased from £13.5m to £23.5m over the fifteen year period to 31 March 2025, to repair the deficit in the defined benefit pension scheme. Employer normal contributions remain at 37.3%.

Counterparty credit risk
We transact with banks for the provision of interest rate and if necessary currency hedging transactions. We maintain a minimum credit rating requirement of 'A' or equivalent with our counterparties, however we recognise that at times the market conditions for banks can be unusually tight.

At the year end there was £34.0m (2011: £11.4m) receivable and £220.4m (2011: £200.5m) payable relating to financial instruments with bank counterparties.

Dividend policy
Our policy is to distribute to shareholders any available surplus funds, after taking into account the cash requirements needed to continue to invest in the business and our level of gearing and is subject to the availability of distributable profits.

Accounting policies
Our 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 and, as previously highlighted in this report, operating profit is stated after writing off replacement expenditure during the year.

Chris Brook
Chief Financial Officer
20 July 2012

Statement of Directors' responsibilities

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). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

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

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

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

The Directors confirm to the best of their knowledge that:

- The financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole as at 31 March 2012; and
- The Directors' report includes a fair and true view of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of its principal risks and uncertainties.

Signed on behalf of the Board of Directors of Scotia Gas Networks Limited:

Gregor Alexander
Chairman
20 July 2012

Board of Directors

Board members

Gregor Alexander
Chairman

Gregor joined the Board at its inception and was appointed the Chairman of SGN 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.

Robert McDonald
Director

Robert joined the Board in July 2006. He is Managing Director Regulation and Strategy at SSE plc and has previously worked with the industry's regulatory body. Robert is a member of the Audit Committee.

Sebastien Sherman
Director

Sebastien joined the Board in March 2007. He is Senior Vice President at Borealis Infrastructure Management Inc. He is Chairman of the Audit Committee and a member of the Safety, Health and Environmental Advisory Committee.

Stephen Dowd
Director

Stephen joined the Board in November 2006 and served as Chairman of SGN from May 2008 to July 2011. He is Senior Vice President (Infrastructure) at Ontario Teachers' Pension Plan Board.

James McPhillimy
Director

James joined the Board at its inception. He is Managing Director Group Services at SSE plc. James is Chairman of the Safety, Health and Environmental Advisory Committee and a member of the People and Reward Committee.

Olivia Steedman
Director

Olivia joined the Board in July 2008. She is a Vice President at Ontario Teachers' Pension Plan Board and is a member of the Audit Committee.

Senior management team

Natalie Bruce
Director

Natalie joined the Board 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.

John McManus
Director

John joined Borealis Infrastructure in 2001 and now leads their London Office. He is jointly responsible for managing the Borealis transaction team and is a Board member for major investments including Bruce Power, Associated British Ports and High Speed One. John joined the board in March 2012.

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.

John Morea and Chris Brook are the senior managers who attend Board meetings.

Registered office
St Lawrence House
Station Approach
Horley, Surrey
RH6 9HJ

Registered auditor
Deloitte LLP
Chartered Accountants and Statutory Auditor, London

Registered number
04958135

Directors' report

The Directors present their report and the audited consolidated financial statements for the year ended 31 March 2012. The financial statements consolidate the financial statements of the Company and its subsidiary undertakings (together the 'Group').

Principal activities
The Company is a holding company which does not trade.

The subsidiary undertakings principally affecting the profits or net assets of the Group in the year are listed in note 13 to the financial statements.

The Group's principal activity is the development, administration, maintenance and safe operation of the Southern and Scotland regional gas distribution systems and the supply of associated transportation, connection and metering services. It will continue these activities for the foreseeable future.

Directors
The Directors of the Company who served during the year ended 31 March 2012, are listed below:

Gregor Alexander (Chairman)
Stephen Dowd
Colin Hood (resigned 27 September 2011)
Robert McDonald
James McPhillimy
Michael Rolland (resigned 27 March 2012)
Sebastien Sherman
Olivia Steedman
Natalie Bruce (appointed 27 September 2011)
John McManus (appointed 27 March 2012)

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, the Company 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 Group are set out in the Financial Review on pages 18 to 22.

Results and dividends
The consolidated profit and loss account is set out on page 32 and is reviewed on pages 18 to 22. The Group paid interim dividends of £130.0m (2011: £60.0m). The Directors do not recommend the payment of any final dividend for the year (2011: £nil).

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

Interest rate risk
The Group has interest bearing liabilities and as a matter of policy a minimum of 75% of debt, excluding shareholder loans, is maintained at either fixed rates of interest or index-linked. The Group uses interest rate swaps, where necessary, in order to achieve the desired profile.

Liquidity risk
The Group maintains a mixture of long-term funding and short-term liquid funds in order that there are sufficient funds available for the Group's current and planned operations.

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

Credit risk
Counterparty credit risks arising from financial derivatives are managed through the maintenance of financial limits, subject to a minimum credit rating of 'A' or equivalent allocated by a recognised major ratings group. In respect of short-term cash management, counter parties 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.

Pricing risk
The Group's gas transportation charges are subject to price control formulae set within the regulatory regime. The Group's maximum allowed revenue in a given price period is dependent upon a number of factors that are not known in advance (such as actual transportation volumes and performance against incentives) 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 and incentive performance, 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.

Charitable contributions
The Group made charitable donations of £78,000 in the year (2011: £75,000) in support of community and employee initiatives across its operations.

There were no political donations in either the current or prior year.

Employees

The Group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the Group. Participation by employees generally is encouraged through team meetings, briefings, an internal newspaper and an intranet site. The Chief Executive Officer and other senior executives regularly communicate with employees through these channels and 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 Group continues and that appropriate training and development is arranged. It is the policy of the Group that the training, career development and promotion of disabled persons should, as far as possible, be identical to that of other employees.

Creditors payment policy

The Group is committed to maintaining good commercial relationships with its creditors and suppliers and its current policy concerning payment is to:

- Agree the terms of payment with those creditors/suppliers when agreeing the terms of each transaction;
- Ensure that those creditors/suppliers were made aware of the terms of payment by inclusion of the relevant terms in contracts; and
- Pay in accordance with its contractual and other legal obligations.

The payment policy applies to all payments to creditors/suppliers for revenue and capital supplies of goods and services without exception.

At 31 March 2012, the Group had an average of 35 days (2011: 29 days) outstanding in its trade creditors. The Company has not traded in either the current or prior year and accordingly has no trade creditors.

Going concern

The Group's financial position, cash flows, liquidity position and borrowing facilities together with the factors likely to affect its future performance and the Group's principal risks and uncertainties are set out in the Financial Review on pages 18 to 22. The Group's financial risk management objectives and risk exposures are set out above.

As stated in the Operational and Financial Review the Group operates the regulated gas distribution networks in South of England and Scotland. The revenue of the Group is regulated by Ofgem via established price control mechanisms based on the distribution network capacity. The Group has considerable financial resources together with committed financing facilities as discussed in note 16 to finance the current and future operations. The Group's forecasts and projections, taking into account reasonably possible changes in trading performance, show that the Group should be able to operate within the level of its current facilities. As a consequence, the Directors believe that the Group 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 and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

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 provisions of section 418 of the Companies Act 2006.

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

By Order of the Board

Nicola Shand
Company Secretary
20 July 2012

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, being unlisted, is not subject to the UK Financial Reporting Council's UK Corporate Governance Code[1] (the 'Governance Code') and the Board of Directors does not believe that all of the guidance set out in the Governance Code is applicable to the Company. However, for the purposes of this statement, the Directors have applied the Governance 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. It has overall responsibility for leading and controlling the Group as well as its financial and operational performance.

As a commercial joint venture, the composition of the Board reflects the shareholders' interests in the consortium. Each of the Directors is an employee of a shareholder or an affiliate of a shareholder of the Company. As the relationship of the shareholders is governed by a Shareholders' and Governance Agreement, any conflict of interest in the position of the Directors would be addressed in accordance with the provisions of the Shareholders' and Governance Agreement. Directors are nominated to the Board in accordance with the terms of the Shareholders' and Governance Agreement. The Directors have been briefed on the duties that have been conferred on them under the Companies Act 2006.

The powers of the Directors are set out in 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. This schedule is reviewed regularly. Furthermore, the Board has established three committees with specific responsibilities to ensure focused and effective leadership. Details of the committees are set out below.

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

Board constitution and appointments

The Board 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.

Biographical details for each of the Directors are set out on pages 24 to 25.

Chairman

Gregor Alexander was appointed as Chairman on 26 July 2011 for a three year period, succeeding Stephen Dowd.

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 25.

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.

Directors' remuneration

The Directors did not receive any remuneration for their services to the Company, or to the Group, during the year ended 31 March 2012 or in the prior year. Accordingly, no further information requires to be disclosed.

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 authorised 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 committees with specific responsibilities. These are the Audit Committee, the Safety, Health and Environmental Advisory Committee and the People and Reward Committee, each of which meets regularly.

Each Committee's performance, constitution and terms of reference are reviewed annually to ensure that they are operating effectively.

[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).

The Company Secretary acts as secretary for each committee and further details are set out below.

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 in the table on page 30.

Audit Committee

The current members of the Audit Committee are Sebastien Sherman (Committee Chairman), Graham Laughland (appointed in 2009 as independent member of the audit committee), Gregor Alexander, Robert McDonald and Olivia Steedman.

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.

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 James McPhillimy (Committee Chairman), Stephen Dowd, Sebastien Sherman, 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 auditor 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 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 Stephen Dowd (Committee Chairman), John McManus (who was appointed as a committee member on 27 March 2012, succeeding Michael Rolland) and James McPhillimy.

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 Chairman 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. Four meetings were held during the year.

Corporate governance statement
continued

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.

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 period 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.

	Board meetings***		Audit Committee meetings		People and Reward Committee meetings		Safety, Health and Environmental Committee meetings	
	Attended	Possible	Attended	Possible	Attended	Possible	Attended	Possible
Gregor Alexander	6	6	3	3	–	–	–	–
Stephen Dowd	5	6	–	–	3	4	3	3
Natalie Bruce*	3	3	–	–	–	–	–	–
Robert McDonald	6	6	3	3	–	–	–	–
James McPhillimy	6	6	–	–	4	4	3	3
Colin Hood*	3	3	–	–	1	1	–	–
Olivia Steedman	6	6	3	3	–	–	–	–
Sebastien Sherman	6	6	3	3	–	–	3	3
Michael Rolland**	3	6	–	–	3	4	–	–
Graham Laughland****	–	–	3	3	–	–	–	–

* With effect from the end of the September 2011 meeting of the Board, Colin Hood resigned as Director and was replaced by Natalie Bruce as a Board Director.

** With effect from the end of the March 2012 meeting of the Board, Michael Rolland resigned as Director and was replaced by John McManus as a Board Director.

*** In addition to the six bi-monthly meetings, there were two extraordinary meetings convened to approve EIB loan facility documentation. An extraordinary meetings' quorum consists of three Directors.

**** Graham Laughland is an independent member of the Audit Committee. He is not a Director of the Company.

Independent auditor's report to the members of Scotia Gas Networks Limited

We have audited the financial statements of Scotia Gas Networks Limited for the year ended 31 March 2012 which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the consolidated and company balance sheets, the consolidated cash flow statement, the reconciliation of net cash flow to movement in net debt and the related notes 1 to 27. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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.

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statements, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practice Board's Ethical Standards for Auditors.

Scope of the audit of financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion

In our opinion the financial statements:

- give a true and fair view of the state of the Group's and the parent Company's affairs as at 31 March 2012 and of the Group's loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on matters prescribed in the Companies Act 2006

In our opinion the information in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company 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.

Makhan Chahal
(Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and
Statutory Auditor
London, United Kingdom
20 July 2012

Consolidated profit and loss account for the year ended 31 March 2012

	Notes	**2012 £m**	2011 £m
Turnover	1, 2	**928.7**	802.0
Net operating costs	3	**(717.8)**	(689.0)
Operating profit	3	**210.9**	113.0
Income from fixed asset investments	13	**0.6**	0.6
Interest receivable and similar income	6	**25.0**	1.3
Interest payable and similar charges	7	**(256.5)**	(236.1)
Loss on ordinary activities before taxation	4	**(20.0)**	(121.2)
Tax (charge)/credit on loss on ordinary activities	8	**(0.5)**	19.0
Loss for the financial year	20	**(20.5)**	(102.2)

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

Consolidated statement of total recognised gains and losses for the year ended 31 March 2012

	Notes	**2012 £m**	2011 £m
Loss for the financial year	20	**(20.5)**	(102.2)
Cash flow hedges (net of deferred tax)	20	**(27.9)**	1.9
Actuarial (loss)/gain recognised on defined benefit pension scheme	26	**(69.1)**	42.4
Movement on deferred tax relating to pension scheme	26	**14.3**	(11.6)
Total recognised losses for the year		**(103.2)**	(69.5)

Balance sheets
as at 31 March 2012

		Group		Company	
	Notes	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Fixed assets					
Intangible assets – goodwill	11	**412.0**	421.6	**–**	–
Tangible assets	12	**3,538.9**	3,504.2	**–**	–
Investments	13	**0.2**	0.2	**2,028.4**	948.4
		3,951.1	3,926.0	**2,028.4**	948.4
Current assets					
Debtors	14	**92.6**	64.8	**91.4**	80.9
Short term deposits		**83.0**	45.8	**83.0**	45.8
		175.6	110.6	**174.4**	126.7
Creditors: amounts falling due within one year	15	**(326.8)**	(285.9)	**(606.4)**	(365.3)
Net current liabilities		**(151.2)**	(175.3)	**(432.0)**	(238.6)
Total assets less current liabilities		**3,799.9**	3,750.7	**1,596.4**	709.8
Creditors: amounts falling due after more than one year	16	**(3,936.3)**	(3,693.4)	**(533.6)**	(533.6)
Provisions for liabilities	18	**(380.4)**	(392.5)	**–**	–
Deferred income	12	**(146.9)**	(130.5)	**–**	–
Net (liabilities)/assets excluding pension liabilities		**(663.7)**	(465.7)	**1,062.8**	176.2
Defined benefit pension liabilities	26	**(83.5)**	(48.3)	**–**	–
Net (liabilities)/assets including pension liabilities		**(747.2)**	(514.0)	**1,062.8**	176.2
Capital and reserves					
Called up share capital	19	**200.0**	200.0	**200.0**	200.0
Hedge reserve	20	**(58.3)**	(30.4)	**–**	–
Profit and loss account	20	**(888.9)**	(683.6)	**862.8**	(23.8)
Shareholders' (deficit)/funds	21	**(747.2)**	(514.0)	**1,062.8**	176.2

The financial statements of Scotia Gas Networks Limited, registered number 04958135, were approved by the Board of Directors on 20 July 2012.

Signed on behalf of the Board of Directors

Gregor Alexander
Director

Sebastien Sherman
Director

Consolidated cash flow statement for the year ended 31 March 2012

	Notes	2012 £m	2011 £m
Net cash inflow from operating activities	22	**310.3**	192.7
Returns on investments and servicing of finance			
Interest paid		**(197.8)**	(194.7)
Interest received		**0.5**	0.7
Dividends received from fixed asset investments		**0.6**	0.6
Net cash outflow from returns on investments and servicing of finance		**(196.7)**	(193.4)
Taxation	8, 27	**1.1**	5.6
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(145.0)**	(140.8)
Sale of tangible fixed assets		**0.2**	0.8
Customer contributions received	12	**19.6**	18.7
Net cash outflow for capital expenditure and financial investment		**(125.2)**	(121.3)
Equity dividends paid	10	**(130.0)**	(60.0)
Net cash outflow before management of liquid resources and financing		**(140.5)**	(176.4)
Management of liquid resources			
(Increase)/decrease in short-term deposits	23	**(37.2)**	92.5
Net cash (outflow)/inflow from management of liquid resources		**(37.2)**	92.5
Financing			
Issue of debt	23	**372.1**	175.0
Repayment of bonds	23	**–**	(325.6)
Settlement of swaps	17	**(8.2)**	75.3
(Repayment)/drawdown of bank borrowings	23	**(171.6)**	170.0
Payments in respect of financial instruments	23	**(12.2)**	(11.6)
Net cash inflow from financing		**180.1**	83.1
Decrease/(increase) in bank overdrafts	23	**2.4**	(0.8)

Reconciliation of net cash flow to movement in net debt for the year ended 31 March 2012

	Notes	**2012 £m**	2011 £m
Decrease/(increase) in bank overdraft in the year		**2.4**	(0.8)
Increase/(decrease) in short-term deposits		**37.2**	(92.5)
Movement in borrowings		**(188.3)**	(83.1)
Change in net debt resulting from cash flows	23	**(148.7)**	(176.4)
Other non-cash changes	23	**(51.9)**	(30.0)
Net debt at beginning of year		**(3,844.0)**	(3,637.6)
Net debt at end of year	23	**(4,044.6)**	(3,844.0)

Notes to the financial statements for the year ended 31 March 2012

1. Principal accounting policies

The financial statements have been prepared in accordance with applicable accounting standards in the United Kingdom and the Companies Act 2006.

The financial statements of the Group present the results for the year ended 31 March 2012. The comparative period presented is the year ended 31 March 2011.

A summary of the more significant Group accounting policies, which have been applied consistently in both years with the exception of the policy on fixed asset investments which is explained below, is as follows:

Change of accounting policy

The accounting policy for the investments in the distribution network subsidiaries has been updated from the historical cost basis to a valuation basis permitted under the alternative valuation rules in the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. Further details of the valuation basis are provided under the fixed asset investments accounting policy below.

The current year impact of this change in accounting policy has been to:

- Increase the Company value of fixed asset investments by £1,080m;
- Increase shareholders' funds of the Company by a corresponding £1,080m.

This change in accounting policy only applies to the distribution network subsidiaries which are Southern Gas Networks plc and Scotland Gas Networks plc. The change has occurred as the Directors believe this to be a more appropriate basis of valuing the investment in distribution network subsidiaries following a review. The comparative figures have not been restated as it would be impractical to perform an historical review of valuation.

Basis of preparation

These financial statements have been prepared under the historical cost convention except that assets and liabilities were stated at fair value when acquired, certain derivative financial instruments are recorded at fair value, and certain fixed asset investments are recorded on a valuation basis.

The financial statements have been prepared on the going concern basis as set out in the Directors' report.

Basis of consolidation

The financial statements consolidate the financial statements of the Company and its subsidiary undertakings drawn up to 31 March each year. Subsidiaries are those entities controlled by the Group or the Company.

Subsidiaries acquired are consolidated in the financial statements of the Group from the date that control commences until the date control ceases, using the acquisition method of accounting.

Intra-Group balances and any unrealised gains and losses or income and expenses arising from intra-Group transactions, are eliminated in preparing the consolidated financial statements.

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 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.

Replacement expenditure

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

Taxation

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

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more or a right to pay less tax in the future have occurred at the balance sheet date, with the following exceptions:

- Provision is made for gains on disposal of fixed assets that have been rolled over into replacement assets only where, at the balance sheet date, there is a commitment to dispose of the replacement assets with no likely subsequent rollover or available capital losses;

Notes to the financial statements for the year ended 31 March 2012
continued

1. Principal accounting policies (continued)

- Provision is made for gains on revalued fixed assets only where there is a commitment to dispose of the revalued assets and the attributable gain can neither be rolled over nor eliminated by capital losses; and
- Deferred tax assets are recognised only to the extent that the Directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing difference can be deducted.

Deferred tax is measured on an undiscounted basis.

Intangible assets – goodwill
Goodwill is capitalised and amortised on a straight line basis to the profit and loss account over its expected useful life. Goodwill represents the excess of the fair value of the consideration paid for the acquisition of businesses over the fair value of the separable net assets acquired.

The useful life of goodwill related to acquired businesses has been estimated to be 50 years.

A review for impairment of goodwill is carried out at the end of each financial year. Impairment reviews comprise a comparison of the carrying amount of the goodwill with its recoverable amount (the higher of net realisable value and value in use). To the extent that the carrying amount exceeds the recoverable amount, the goodwill is impaired and an impairment loss is recognised in the profit and loss account.

Fixed asset investments
Except for the Company's investment in shares of Southern Gas Networks plc and Scotland Gas Networks plc, 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.

Investments in the shares of distribution networks which include Southern Gas Networks plc and Scotland Gas Networks plc are stated at market value as at the date of their last valuation under the alternative valuation rules in the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

Tangible fixed assets
Tangible fixed assets are stated at cost less depreciation and any provision for impairment. The cost is the purchase cost of the asset, together with any directly attributable costs of acquisition. In respect of assets purchased as part of a business combination, the cost is the fair value of the assets acquired.

The carrying values of tangible fixed assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

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

Freehold buildings	Up to 50 years
Leasehold buildings	Over the shorter of lease term and 50 years
Plant and machinery:	
– Mains and services	60 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.

Grants and contributions
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. Deferred income in respect of revenue grants and contributions is included within creditors: amounts falling due within one year.

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, except where the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate is shorter than the full lease term, in which case the shorter period is used.

Pensions
Defined benefit pension scheme
The amounts charged to the profit and loss account are the current service costs and gains and losses on settlements and curtailments. They are included within staff costs. Past service costs are recognised immediately in the profit and loss account if the benefits have vested. If the benefits have not vested immediately the costs are recognised over the period until vesting occurs. The interest cost and the expected return on the assets are shown as a net amount of other finance costs or credits within interest payable or receivable. Actuarial gains and losses are recognised immediately in the consolidated statement of total recognised gains and losses.

The defined benefit scheme is funded, with the assets of the scheme held separately from those of the Group, in separate trustee administered funds. Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date.

The resulting defined benefit asset or liability, net of the related deferred tax, is presented separately after other net assets on the face of the balance sheet. Any pension asset is recognised in the balance sheet to the extent that the benefits may be derived from the surplus in the form of reduced cash contributions in the future or cash refunds.

Defined contribution pension schemes
The Group also operates defined contribution pension schemes. The assets of the schemes are held separately from those of the Group in independently administered funds. The amounts charged to the profit and loss account represent the contributions payable to the schemes in the period. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

Provisions
A provision is recognised in the balance sheet when the Group 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.

Financial instruments
The Group'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.

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).

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.

Impairment of financial assets
Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

Notes to the financial statements for the year ended 31 March 2012
continued

1. Principal accounting policies (continued)

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

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Derecognition of financial assets
The Group 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.

Trade debtors
Trade debtors are initially recognised at fair value. The carrying amount is reduced through the use of an allowance account. Appropriate allowances 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 allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

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

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

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 Group 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 group 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 Group's documented risk management or investment strategy and information about the Group is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives and IAS 39 Financial Instruments: Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL.

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.

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.

De-recognition of financial liabilities
The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire.

Derivative financial instruments and hedge accounting
The Group 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 Group 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 Group 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. Changes in fair value of derivatives that are designated and are effective as fair value hedges are recognised in the profit and loss account but effectively offset changes in fair value of the hedged item.

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. Segmental reporting

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.

3. Operating profit and net operating costs

	2012 £m	2011 £m
Turnover	**928.7**	802.0
Distribution costs	**(721.3)**	(692.6)
Profit on disposal of fixed assets	**0.2**	0.8
Other operating income	**3.3**	2.8
Total net operating costs	**(717.8)**	(689.0)
Operating profit	**210.9**	113.0

Distribution costs include the costs of operating the distribution network together with depreciation, goodwill amortisation and replacement expenditure.

4. Loss on ordinary activities before taxation

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

	2012 £m	2011 £m
Auditor's remuneration	**0.4**	0.3
Goodwill amortisation	**9.6**	9.5
Depreciation of owned assets	**109.0**	105.0
Profit on disposal of fixed assets	**(0.2)**	(0.8)
Replacement expenditure	**260.6**	256.0
Impairment of trade debtors	**–**	–
Rentals under operating leases – other assets	**0.5**	1.1

Auditor's remuneration for the Group comprises £175,000 (2011: £187,000) in respect of statutory and regulatory audit services, £50,000 (2011: £50,000) in respect of other services pursuant to legislation, £44,000 (2011: £nil) in respect of bond issue assurance work, £24,000 (2011: £29,000) in respect of IT consultancy services, £75,000 (2011: £nil) in respect of regulatory consulting services, £35,000 (2011: £nil) in respect of tax consultancy services, and £nil (2011: £20,000) in respect of the capital reduction.

Auditor's remuneration in respect of statutory audit services for the Company amounted to £10,000 (2011: £10,000).

In addition to the above services, the Group's auditor acted as auditor to the Scotia Gas Networks Pension Scheme and fees of £16,000 (2011: £15,000) have been charged by the auditor to the Group in respect of these services.

Notes to the financial statements for the year ended 31 March 2012
continued

5. Employee information and Directors' emoluments

The Group had 3,787 full time equivalent employees as of 31 March 2012 (2011: 3,921). The average monthly number of full time equivalent employees during the year was 3,854 (2011: 3,993).

The Directors did not receive any remuneration for their services to the Group during the year, or during the prior 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 Group.

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

	2012 £m	2011 £m
Staff costs		
Wages and salaries	**136.5**	136.4
Social security costs	**12.8**	12.4
Pension costs	**23.7**	24.7
	173.0	173.5

The Company had 9 employees as of 31 March 2012 (2011: 9).

6. Interest receivable and similar income

	2012 £m	2011 £m
Interest receivable on short-term deposits	**0.5**	0.7
Other finance income:		
Movement on financial derivatives (see note 17)	**22.6**	0.6
Net pension credit (see note 26)	**1.9**	–
Total interest receivable and similar income	**25.0**	1.3

7. Interest payable and similar charges

	2012 £m	2011 £m
Bank loans	**0.2**	0.2
Index-linked bond interest	**58.6**	54.1
Other interest payable on bonds	**107.7**	100.6
Shareholders' loan interest (see note 27)	**66.7**	66.7
Other interest payable	**7.9**	7.2
Net pension charge (see note 26)	**–**	0.1
Unwind of discounts in provisions (see note 18)	**15.4**	7.2
	256.5	236.1

8. Tax (charge)/credit on loss on ordinary activities

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

	2012 £m	2011 £m
Current tax		
Corporation tax at 26% (2011: 28%)	–	–
Adjustment in respect of prior year	1.1	5.6
Total current tax credit	1.1	5.6
Deferred tax		
Deferred tax (charge)/credit for the year	(1.6)	19.8
Adjustments in respect of prior year	–	(6.4)
Total deferred tax (charge)/credit for the year	(1.6)	13.4
Total tax (charge)/credit on loss on ordinary activities	**(0.5)**	19.0

b) Factors affecting the current tax credit for the year

	2012 £m	2011 £m
Loss on ordinary activities before tax	(20.0)	(121.2)
Loss on ordinary activities multiplied by standard rate of corporation tax in the UK of 26% (2011: 28%)	5.2	33.9
Effects of:		
Non taxable income	0.2	0.2
Deferred tax on accelerated capital allowances	5.5	7.5
Deferred tax recognised on unutilised losses	(0.8)	(23.5)
Utilisation of losses brought forward	5.0	–
Depreciation on non-qualifying assets	(7.6)	(8.0)
Other short-term timing differences	10.6	10.9
Tax losses not recognised	(15.0)	(18.0)
Expenses not deductible for tax purposes	(3.1)	(3.0)
Adjustment in respect of prior year – proceeds from sale of tax losses	1.1	5.6
Current tax credit	**1.1**	5.6

The Budget on 21 March 2012 announced an additional 1% reduction in the main rate of corporation tax, giving a rate of 24% (previously 25%) from 1 April 2012. As this rate change was substantively enacted at the balance sheet date, deferred tax has been restated accordingly in these financial statements. This has the effect of reducing the Group's net deferred tax liabilities recognised at 31 March 2012 by £18.7m (2011: £14.9m).

The budget also revised the previously announced phased reduction in the main rate of corporation tax to 23% from 1 April 2013 (previously 24%) and 22% from 1 April 2014 (previously 23%). It has not yet been possible to quantify the full anticipated effect of the announced further 2% reductions, due to legislation not being enacted, although this will further reduce the Group's future current tax charge and reduce the Group's deferred tax liabilities accordingly.

9. Loss of the Company for the financial year

The Company's loss for the year amounted to £63.4m (2011: Loss of £18.3m). In accordance with the exemption available under section 408 of the Companies Act 2006, no separate profit and loss account is presented in respect of the Company.

10. Dividends

	2012 £m	2011 £m
Equity shares		
Interim dividends paid of 27.6566p (2011: 12.7646p)	130.0	60.0

Notes to the financial statements for the year ended 31 March 2012
continued

11. Intangible fixed assets

Group

	Goodwill £m
Cost	
At 1 April 2011 and at 31 March 2012	**477.6**
Accumulated amortisation	
At 1 April 2011	56.0
Charge for the year	9.6
At 31 March 2012	**65.6**
Net book value	
At 31 March 2012	**412.0**
At 31 March 2011	421.6

The goodwill, which arose on the acquisitions of Scotland Gas Networks plc and Southern Gas Networks plc, 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 businesses acquired are 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 either the current or the prior year.

12. 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 2011	0.7	66.6	3,772.4	183.6	4,023.3
Additions	–	2.3	121.3	20.1	143.7
At 31 March 2012	**0.7**	**68.9**	**3,893.7**	**203.7**	**4,167.0**
Depreciation					
At 1 April 2011	0.1	7.6	444.9	66.5	519.1
Charge for the year	–	2.5	85.3	21.2	109.0
At 31 March 2012	**0.1**	**10.1**	**530.2**	**87.7**	**628.1**
Net book value					
At 31 March 2012	**0.6**	**58.8**	**3,363.5**	**116.0**	**3,538.9**
At 31 March 2011	0.6	59.0	3,327.5	117.1	3,504.2

The Group had no assets held under finance leases in the current or prior financial year.

The Company had no tangible fixed assets in either year.

The Group has received customer contributions relating to plant and machinery. In accordance with the Group's accounting policy the assets are capitalised within fixed assets and the contributions are recognised as deferred income in the balance sheet. 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:

Deferred income

	Group 2012 £m	Group 2011 £m
Customer contributions brought forward	**130.5**	114.6
Customer contributions received in year	**19.6**	18.7
Amortisation in year	**(3.2)**	(2.8)
	146.9	130.5

The Company has no deferred income.

13. Fixed asset investments

Cost or valuation and net book value

	Group £m	Company £m
Shares in Group undertakings		
At 1 April 2011 (at cost)	–	948.4
Revaluation	–	1,080.0
At 31 March 2012	–	2,028.4
Other investments		
At 1 April 2011 and at 31 March 2012	0.2	–
	0.2	**2,028.4**

The Company's investments in Southern Gas Networks plc and Scotland Gas Networks plc were valued at 16 June 2011 by an independent firm of professional valuers. The revaluation was undertaken using a discounted cash flow technique. Subsequent to the valuation a gain of £1,080m has been recognised in the financial statements.

Other fixed asset investments
Other fixed asset investments relate to the Group's investments in Xoserve Limited, which provides transportation transactional services on behalf of all the major gas network transportation companies. The Group holds 23.1% (2011: 23.1%) of the ordinary shares of Xoserve Limited.

During the year the Group received dividends of £0.6m (2011: £0.6m) in relation to this investment.

Interests in Group undertakings
Details of the principal subsidiary undertakings at the end of the year, which are directly wholly owned by the Company, are as follows:

Name of subsidiary	Description of shares held	Country of registration	Principal activities
Southern Gas Networks plc	160,174,772 ordinary shares of £1 each	England & Wales	Development, administration, maintenance and operation of regional gas distribution system and supply of transportation services.
Scotland Gas Networks plc	49,392,787 ordinary shares of £1 each	Scotland	Development, administration, maintenance and operation of regional gas distribution system and supply of transportation services.
SGN Contracting Limited	1 ordinary share of £1	England & Wales	Supply of contracting services.
SGN Connections Limited	1 ordinary share of £1	England & Wales	Supply of gas connections services.
SGN Commercial Services Limited	1 ordinary share of £1	England & Wales	Meter asset manager and supply of commercial services.

Notes to the financial statements for the year ended 31 March 2012
continued

14. Debtors

	Group		Company	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Amounts falling due within one year				
Trade debtors	**50.3**	44.8	**–**	–
Amounts owed by Group undertakings	**–**	–	**91.4**	80.9
Prepayments and accrued income	**8.3**	8.6	**–**	–
Derivative financial instruments (see note 17)	**34.0**	11.4	**–**	–
	92.6	64.8	**91.4**	80.9

Trade debtors are stated net of bad debt provisions of £0.3m (2011: £0.3m) and credit note provisions of £3.7m (2011: £2.0m).

Within amounts owed by Group undertakings are loans amounting to £91.4m (2011: £80.9m) which incur interest at 1.5% (2011: 1.5%).

15. Creditors: amounts falling due within one year

	Group		Company	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Bank loans and overdrafts	**4.9**	7.3	**–**	–
Trade creditors	**58.0**	38.0	**–**	–
Amounts owed to Group undertakings	**–**	–	**583.8**	342.8
Other taxation and social security	**26.4**	27.8	**0.2**	0.2
Other creditors	**5.1**	3.6	**–**	–
Accrued interest	**68.7**	61.2	**22.4**	22.3
Other accruals	**79.3**	85.5	**–**	–
Deferred income	**14.2**	18.6	**–**	–
Derivative financial instruments (see note 17)	**70.2**	43.9	**–**	–
	326.8	285.9	**606.4**	365.3

The amounts owed to Group undertakings represents loans which incur interest at 0.5% (2011: 0.5%).

16. Creditors: amounts falling due after more than one year

	Group		Company	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Bonds:				
Fixed rate and index-linked:				
£165m 2.127% index-linked due 2022	**204.6**	194.5	**–**	–
£250m 2.013% index-linked due 2035	**310.0**	294.6	**–**	–
£150m 2.066% index-linked due 2025	**186.0**	176.8	**–**	–
£15m 2.580% index-linked due 2028	**16.8**	16.0	**–**	–
£125m 2.31% index-linked due 2039	**138.7**	133.3	**–**	–
£257m 4.75% fixed rate due 2017	**255.9**	255.7	**–**	–
£300m 5.25% fixed rate due 2018	**298.2**	298.1	**–**	–
£225m 4.875% fixed rate due 2034	**224.5**	224.3	**–**	–
£215m 4.875% fixed rate due 2020	**214.5**	214.3	**–**	–
£375m 4.875% fixed rate due 2029	**373.6**	373.5	**–**	–
£225m 6.38% fixed rate due 2040	**223.5**	223.5	**–**	–
£25m 3.12% fixed rate due 2018	**25.0**	25.0	**–**	–
£25m 3.25% fixed rate due 2018	**25.0**	25.0	**–**	–
£300m 4.875% fixed rate due 2023	**297.1**	–	**–**	–
£25m 3.634% fixed rate due 2020	**25.0**	–	**–**	–
£50m 3.765% fixed rate due 2020	**50.0**	–	**–**	–
	2,868.4	2,454.6	**–**	–
Floating rates:				
£233m floating rate loan note due 2015	**232.8**	232.6	**–**	–
£100m floating rate loan note due 2015	**99.9**	99.8	**–**	–
£80m floating rate loan note due 2043	**79.6**	79.5	**–**	–
£75m floating rate loan note due 2018	**75.0**	75.0	**–**	–
£50m floating rate loan note due 2019	**50.0**	50.0	**–**	–
	537.3	536.9	**–**	–
Total bonds	**3,405.7**	2,991.5	**–**	–
Revolving credit facility drawn	**(3.0)**	168.3	**–**	–
Shareholders' loans (see note 27)	**533.6**	533.6	**533.6**	533.6
	3,936.3	3,693.4	**533.6**	533.6

The shareholder loans, which are subordinated, are redeemable at par on 31 May 2015, or may be redeemed at par by the Company by giving due notice. Interest accrues at a fixed rate of 12.5% per annum and the Company may, upon giving due notice, elect to pay some or all of the interest payable through the issuance of further loans to shareholders.

The total revolving credit facility is £280.0m and expires in December 2016.

Maturity of borrowings

	Group	
	2012 £m	2011 £m
Due within one year	**–**	–
Between one and five years	**1,122.1**	1,034.3
After five years	**2,814.2**	2,659.1
	3,936.3	3,693.4

The Company's borrowings all fall due on 31 May 2015.

The above borrowings are unsecured and are stated after the deduction of unamortised issue costs of £15.6m (2011: £12.6m). 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.

Notes to the financial statements for the year ended 31 March 2012
continued

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

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 2012 is £153.2m (2011: £112.5m).

17. Financial instruments

The Group's funding, liquidity and exposure to interest rate, foreign currency exchange and credit risks are managed within a frame work 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 the prospectus issued by the Company for the medium term note programme, financial derivatives are used to manage financial exposures.

The Treasury function is responsible for managing banking and liquidity requirements of the Group, risk management relating to interest rate and foreign exchange exposures and for managing the credit risk relating to banking counterparties with which it transacts. The function's operations are governed by policies determined by the Board.

Categories of financial instruments
The categories of financial assets and liabilities held by the Group were as follows:

	Book Value	
	2012 £m	2011 £m
Financial assets held at amortised cost		
Trade debtors (1)	**50.3**	44.8
Short term deposits (1)	**83.0**	45.8
	133.3	90.6
Financial assets at fair value		
Derivative financial instruments through the profit and loss account	**34.0**	11.4
Available for sale financial assets (1)	**0.2**	0.2
Total financial assets	**167.5**	102.2

(1) The carrying amount of financial assets approximates to their fair value.

	Book Value	
	2012 £m	2011 £m
Financial liabilities held at amortised cost		
Trade creditors	**58.0**	38.0
Accrued interest	**68.7**	61.2
Other accruals	**79.3**	85.5
Bank loans and overdrafts	**4.9**	175.6
Bonds	**3,405.7**	2,991.5
Shareholder loans	**533.6**	533.6
	4,150.2	3,885.4
Financial liabilities at fair value		
Bonds	**–**	–
Derivative financial instruments in designated hedging relationships	**70.2**	43.9
Onerous contract swaps	**150.2**	156.6
	220.4	200.5
Total financial liabilities	**4,370.6**	4,085.9

The carrying amount of financial liabilities approximates to their fair value except for bonds and shareholder loans, the fair value of which is disclosed on the next page.

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1: Valued using unadjusted quoted prices in active markets for identified financial instruments.

- Level 2: Valued using techniques based significantly on observable market data. Instruments in this category are valued using valuation techniques where all of the inputs that have a significant impact on the valuation are directly or indirectly based on observable market data.
- Level 3: Instruments in this category have been valued using a valuation technique where at least one input (which has a significant input on the financial instruments' valuation) is not based on observable market data. Where inputs can be observed from market data with not undue cost and effort, the observed input is used. Otherwise management determines a reasonable estimate for the input.

An analysis of financial assets and liabilities that are recorded at fair value at 31 March 2012 is as follows:

	2012			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
At fair value through profit and loss				
– other financial assets (derivatives)	–	34.0	–	34.0
	–	**34.0**	**–**	**34.0**
Financial liabilities				
At fair value through profit and loss				
– other financial liabilities (onerous contract swaps)	–	150.2	–	150.2
Derivatives used for hedging	–	70.2	–	70.2
	–	**220.4**	**–**	**220.4**

	2011			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
At fair value through profit and loss				
– other financial assets (derivatives)	–	11.4	–	11.4
	–	**11.4**	**–**	**11.4**
Financial liabilities				
At fair value through profit and loss				
– other financial liabilities (onerous contract swaps)	–	156.6	–	156.6
Derivatives used for hedging	–	43.9	–	43.9
	–	**200.5**	**–**	**200.5**

Onerous contract swaps
In 2005 the Group entered into interest rate swap contracts to fix the Group's interest cost relating to (floating rate) bridging loans which were in place at the time. In October 2005, permanent long-term capital markets debt was issued to replace floating rate bridging loans. At that point these swaps became obsolete and consequently matching swaps were transacted (under which the Group received fixed rate interest) to close out the position. The crystallised loss was recognised in the profit and loss and a discounted provision equal to the market value of the matched swaps was established under onerous contract provision (see note 18). At 31 March 2012 the provision for onerous contract swap loss was £150.2m (2010: £156.6m).

Fair values
The Group's financial instruments recorded at amortised cost are shown below together with their fair values:

	31 March 2012		31 March 2011	
	Book Value £m	**Fair Value £m**	Book Value £m	Fair Value £m
Bonds	**3,405.7**	**3,566.7**	2,991.5	3,168.3
Shareholder loans	**533.6**	**570.9**	533.6	545.4
	3,939.3	**4,137.6**	3,525.1	3,713.7

Fair values of bonds and shareholder loans have been determined by reference to closing quoted market values where available or otherwise by discounting future cash flows at their market interest rate.

The carrying value of all other financial assets and liabilities approximates to their book value.

Notes to the financial statements for the year ended 31 March 2012
continued

17. Financial instruments (continued)

Risks
Exposure to counterparty credit risk, interest rate risk, currency risk and liquidity risk arise in the normal course of business. The extent of any exposures and the policies implemented to manage them are set out below:

Credit risk
Credit risk is the risk that a counterparty will default on its obligation resulting in financial loss to the Company.

The maximum exposure to credit risk is the carrying value of financial assets as follows:

	2012 £m	2011 £m
Net trade receivables	**50.3**	44.8
Financial derivative assets	**34.0**	11.4
Short term deposits	**83.0**	45.8
	167.3	102.0

Counterparty credit risks arising from financial derivatives are managed through the maintenance of financial limits, subject to a minimum credit rating of 'A' or equivalent allocated by a recognised major ratings group. In respect of short-term cash management, counterparties are subject to review and approval according to defined criteria. The Group conducted a review of counterparty credit risk and concluded that no adjustment was required to reflect the net credit risk in arriving at the fair value of financial instruments stated in the balance sheet.

Trade debtors 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.

Trade debtors from non-transportation income relates to consumers and businesses in relation to works for alterations, diversions, meters or damage repairs. In 2011/12 non-transportation debtors were 12.5% (2011: 17.2%) of net trade debtors. An impairment allowance has been set aside according to the Group's impairment policy.

The largest transportation debtor is £12.3m (2011: £10.6m). There is no material credit exposure to any one customer.

The ageing of trade debtors net of impairment allowance were:

	2012 £m	2011 £m
Not past due	**49.7**	44.0
Past due 0-30 days	**0.6**	0.8
Past due 31-90 days	**–**	–
Past due over 90 days	**–**	–
	50.3	44.8

The movement in the allowance for impairment of trade debtors was:

	2012 £m	2011 £m
Balance at 1 April	**0.3**	0.3
Decrease in allowance for impairment	**–**	(0.1)
Balance at 31 March	**0.3**	0.2

In addition there are credit note provisions against trade debtors of £3.7m (2011: £2.0m).

The amount released of £0.1m is in respect of debtors 30 days past. None of the trade debtors that are past due or impaired have had their terms renegotiated.

The maximum exposure to credit risk at the reporting date is the fair value of each class of debtors mentioned above. The Company does not hold any collateral as security.

At the end of each reporting period a review of the provision for bad and doubtful debts is performed taking in to account the age, status and risk of recovery for each debtor.

Liquidity risk

Liquidity risk, the risk that the Group will have insufficient funds to meet liabilities as they fall due, is ultimately managed by the treasury function, which has defined an appropriate liquidity risk framework for the management of the Group's short, medium and long-term funding and liquidity requirements. The Group manages liquidity risk by maintaining adequate reserves, banking facilities and reserve borrowing facilities by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

The contractual maturity of the Group's financial assets and liabilities are shown in the following tables. The amounts shown are gross cash inflows/(outflows) with the exception of financial derivatives settled on a net basis where the amounts represent undiscounted net cash flows. When the amount payable is not fixed, the amount disclosed is determined by reference to relevant conditions existing at the reporting date.

2012

	0-6 months £m	6-12 months £m	1-2 years £m	2-5 years £m	> 5 years £m	Contractual cash flows £m	Interest/ discounting £m	Carrying value £m
Financial liabilities loans and borrowings								
Bank overdrafts	(4.9)	–	–	–	–	(4.9)	–	(4.9)
Shareholder loans	(33.4)	(33.4)	(66.8)	(611.8)	–	(745.4)	211.8	(533.6)
Bonds	(47.5)	(78.9)	(126.7)	(710.6)	(4,869.9)	(5,833.6)	2,427.9	(3,405.7)
	(85.8)	(112.3)	(193.5)	(1,322.4)	(4,869.9)	(6,583.9)	2,639.7	(3,944.2)
Derivative financial liabilities								
Hedging interest rate swaps	(8.5)	2.1	(6.2)	(6.4)	(80.9)	(99.9)	63.7	(36.2)
Onerous contract swaps	(9.8)	(9.9)	(19.8)	(55.0)	(70.3)	(164.8)	14.6	(150.2)
	(18.3)	(7.8)	(26.0)	(61.4)	(151.2)	(264.7)	78.3	(186.4)
Other financial liabilities								
Trade and other creditors	(58.0)	–	–	–	–	(58.0)	–	(58.0)
Total financial liabilities	**(162.1)**	**(120.1)**	**(219.5)**	**(1,383.8)**	**(5,021.1)**	**(6,906.6)**	**2,718.0**	**(4,188.6)**

The Group expects to meets its obligations from cash balances, operating cash flows and re-financing.

The corresponding amounts for 2011 were as follows:

2011

	0-6 months £m	6-12 months £m	1-2 years £m	2-5 years £m	> 5 years £m	Contractual cash flows £m	Interest/ discounting £m	Carrying value £m
Financial liabilities loans and borrowings								
Bank overdrafts	(7.3)	–	–	–	–	(7.3)	–	(7.3)
Bank loans	(5.1)	(5.1)	(20.4)	(170.0)	–	(200.6)	32.3	(168.3)
Shareholder loans	(33.4)	(33.4)	(66.8)	(678.6)	–	(812.2)	278.6	(533.6)
Bonds	(45.8)	(62.0)	(108.7)	(661.0)	(4,474.8)	(5,352.3)	2,360.8	(2,991.5)
	(91.6)	(100.5)	(195.9)	(1,509.6)	(4,474.8)	(6,372.4)	2,671.7	(3,700.7)
Derivative financial liabilities								
Hedging interest rate swaps	(8.8)	2.5	(6.2)	(16.0)	(80.7)	(109.2)	76.7	(32.5)
Onerous contract swaps	(9.9)	(9.9)	(19.7)	(56.0)	(89.2)	(184.7)	28.1	(156.6)
	(18.7)	(7.4)	(25.9)	(72.0)	(169.9)	(293.9)	104.8	(189.1)
Other financial liabilities								
Trade and other creditors	(38.0)	–	–	–	–	(38.0)	–	(38.0)
Total financial liabilities	**(148.3)**	**(107.9)**	**(221.8)**	**(1,581.6)**	**(4,644.7)**	**(6,704.3)**	**2,776.5**	**(3,927.8)**

Notes to the financial statements for the year ended 31 March 2012
continued

17. Financial instruments (continued)

Currency risk
The Group generally transacts in sterling denominated currency with the exception of certain material purchases and bond financing.

The Group enters into cross currency swap agreements from time to time with the effect of converting contractual commitments denominated in foreign currencies into sterling obligations. At 31 March 2012 the Group had minimal foreign currency exposure in relation to purchase contract commitments, or bond financing.

Inflation risk
The Group's index-linked borrowings and interest liabilities are exposed to a risk of change in the carrying value due to changes in the UK Retail Price Index ('RPI'). This form of liability is a good match to the Group's regulated asset value which is also index-linked to RPI due to the pricing mechanism imposed by the regulator. The turnover capacity charges are also linked to RPI.

By matching liabilities and assets, index-linked debt hedges the exposure to changes in RPI and delivers cash flow benefit. The compensation for the inflation risk is recorded as payable on the balance sheet with the principal, as opposed to a cash payment.

Assuming sensitivity to the RPI does not take into account the changes to revenue or operating costs that are affected by RPI or inflation generally, the following table shows the illustrative effect on the profit and loss account that would result from a 1% movement in RPI before the effects of tax.

	2012 £m	2011 £m
Impact on profit and loss		
Index-linked bonds accretion	**8.2**	8.1
Transportation income	**(9.1)**	(7.4)
Total	**(0.9)**	0.7

Interest rate risk
The Group limits the impact of interest rate risk by implementing a policy of a minimum of 75% of borrowing being either at fixed or index-linked, excluding borrowing from shareholders. Derivative financial instruments are transacted to hedge risk in accordance with this policy.

The impact of a change in interest rates on financial derivatives is dependent on whether their designation is fair value through the profit or loss, or if designated as cash flow hedges then the impact will be through equity.

The following table represents the annualised impact (net of deferred tax) of 100 basis point change in short-term interest rates at the reporting date in relation to equity and profit and loss account. The analysis assumes that all other variables remain constant.

	2012 £m	2011 £m
Impact on profit and loss account		
Floating rate instruments	**(7.1)**	(7.1)
Fixed to floating swaps	**(2.7)**	(2.7)
	(9.8)	(9.8)
Impact on equity		
Floating to fixed swaps	**3.6**	3.6

Cash flow hedges
Cash flow hedges comprise floating to fixed interest rate swaps of future interest payments relating to existing bonds. Receipts and payments for the swaps and the underlying bonds are exactly matched and in accordance with FRS 26 any gain or loss that is deferred to equity is recognised in profit or loss over the period that the floating rate interest payments impact on profit.

In September 2011 the Company issued a £300m 12 year fixed rate bond. Prior to the bond issue, from July to August 2011 the Company entered into six floating to fixed rate 10 year swaps of £25m each, to hedge the fixed interest rates prevalent in the market. After the issue of fixed rate bonds, the floating to fixed rate swaps were cancelled and a loss of £8.2m was recognised.

The swaps were entered to hedge future interest outflows on the bond and therefore were effective hedging instruments. In accordance with the requirements of FRS 26 (Financial Instruments Recognition and Measurement) the loss arising on settlement of the swaps has been recorded in equity. The loss will be recycled to profit and loss account over 10 years. As at 31 March 2012 the unamortised hedge loss balance in equity was £7.8m.

The movement before deferred tax taken to equity in respect of cash flow hedges in the year was £25.4m loss (2011: £4.2m gain). The hedge reserve movement is expected to unwind in profit or loss over the life of the swaps.

The notional principal amount of the outstanding cashflow hedges at 31 March 2012 was £363.0m (2011: £363.0m). At 31 March 2012 the fixed interest rates vary from 3.1% to 6.3% and floating rates 2.7% (Libor plus 140bp).

Fair value hedges
The Group has no fair value hedges at 31 March 2012.

Movement in derivatives included in profit and loss account
The net movement included within interest in the profit and loss account for financial derivatives is as follows:

	2012 £m	2011 £m
Net fair value gain/(losses)	**14.8**	(7.6)
Less: net amounts received	**7.8**	8.2
Net movement in financial derivatives	**22.6**	0.6

In addition the movement on onerous swap contracts in the period was a loss of £13.6 (2011: £5.3m) included in discount unwind within interest payable.

18. Provisions for liabilities

Group

	Onerous financial instruments £m	Environmental £m	Deferred tax £m	Other provisions £m	Total £m
At 1 April 2011	156.6	29.4	200.2	6.3	392.5
Arising during the year	–	0.9	–	1.3	2.2
Utilised during the year	(20.0)	(0.3)	–	(0.7)	(21.0)
Net movement in deferred tax	–	–	(8.7)	–	(8.7)
Amortisation of discount	13.6	1.8	–	–	15.4
At 31 March 2012	**150.2**	**31.8**	**191.5**	**6.9**	**380.4**

Onerous financial instruments
The onerous financial instruments provision relates to interest rate swap contracts which the Group holds (see note 17). The provision recorded at each balance sheet date represents the aggregate fair value of the swap contracts held. The provision will be utilised as cash settlement payments are made over the life of the swaps over the next thirteen years.

Environmental
The environmental provision represents the Directors' best estimate of environmental restoration costs, where the Group 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 estimated expenditure to settle the obligation. This provision is expected to be utilised over the next nineteen years.

Notes to the financial statements for the year ended 31 March 2012
continued

18. Provisions for liabilities (continued)

Deferred tax
The net movement on the deferred tax provision has arisen as a result of a surrender of tax losses during the year, offset by other movements in the year of which £3.5m is recorded as a credit to the profit and loss account and £5.2m is recorded as a credit to the statement of total recognised gains and losses.

The Company has no provisions in either year.

Deferred tax recognised in the financial statements (excluding deferred tax recognised in respect of pension liabilities – see note 26) is as follows:

	Group		Company	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Accelerated capital allowances	**(271.5)**	(289.4)	**–**	–
Deferred tax asset on losses	**56.8**	66.4	**–**	–
Deferred tax on cash flow hedges	**16.8**	11.4	**–**	–
Other timing differences	**6.4**	11.4	**–**	–
	(191.5)	(200.2)	**–**	–

The movement in provision for deferred tax is as follows:

	Group	
	2012 £m	2011 £m
At 1 April	**(200.2)**	(224.8)
Charged to profit and loss account	**3.5**	26.7
Charged to statement of recognised gains and losses	**5.2**	(2.1)
At 31 March	**(191.5)**	(200.2)

The Group has unrecognised deferred tax assets in respect of unutilised tax losses of £276.7m (2011: £253.2m). Deferred tax assets have been recognised in respect of tax losses to the extent that it is considered probable that these assets will be recovered. Deferred tax assets have not been recognised in respect of unutilised tax losses in the Company amounting to £66.4m (2011: £65.8m).

In accordance with FRS 19 ('Deferred tax'), deferred tax has been measured based upon a corporation tax rate of 24% (2011: 26%), being the tax rate substantively enacted at the balance sheet date.

Other provisions
This represents a provision for other legal and constructive obligations held by the Group. This provision is expected to be utilised over the next thirteen years.

19. Share capital

	31 March 2012		31 March 2011	
	Number	**Value (£m)**	Number	Value (£m)
Allotted, called up and fully paid shares				
'A' ordinary shares of 42.55p (2011: 42.55p) each	**235,025,002**	**100.0**	235,025,002	100.0
'B' ordinary shares of 42.55p (2011: 42.55p) each	**117,512,501**	**50.0**	117,512,501	50.0
'C' ordinary shares of 42.55p (2011: 42.55p) each	**117,512,501**	**50.0**	117,512,501	50.0
Total	**470,050,004**	**200.0**	470,050,004	200.0

The 'A', 'B' and 'C' ordinary shares rank pari passu in all respects.

During the year the Directors of the Company approved a scheme to allot 1,080m bonus shares with a nominal value of £1 out of a revaluation reserve created by the revaluation of fixed asset investments (see note 13). At the same time the Directors approved a share capital reduction to cancel the rights of those shares and reduce the share capital by £1,080m (1,080m shares of £1 each).

20. Reserves

	Hedge reserve		Revaluation reserve		Profit and loss account	
	Group £m	Company £m	Group £m	Company £m	Group £m	Company £m
At 1 April 2011	(30.4)	–	–	–	(683.6)	(23.8)
Loss for the financial year	–	–	–	–	(20.5)	(63.4)
Reduction of capital (see note 19)	–	–	–	–	–	1,080.0
Revaluation (see note 13)	–	–	–	1,080.0	–	–
Bonus issue of shares	–	–	–	(1,080.0)	–	–
Dividends paid on equity shares (see note 10)	–	–	–	–	(130.0)	(130.0)
Movement on cash flow hedges	(33.1)	–	–	–	–	–
Deferred tax on cash flow hedges	5.2	–	–	–	–	–
Actuarial loss on defined benefit pension scheme (net of related tax)	–	–	–	–	(54.8)	–
At 31 March 2012	**(58.3)**	**–**	**–**	**–**	**(888.9)**	**862.8**

The loss on cash flow hedges includes £7.8m recognised on swaps entered into and settled during the year (see note 17 for details).

21. Reconciliation of movements in Group shareholders' deficit

	2012 £m	2011 £m
Loss for the financial year	**(20.5)**	(102.2)
Dividend paid on equity shares (see note 10)	**(130.0)**	(60.0)
Cash flow hedges (net of deferred tax)	**(27.9)**	1.9
Actuarial (loss)/gain on defined benefit pension scheme (net of related tax)	**(54.8)**	30.8
Movement in shareholders' deficit	**(233.2)**	(129.5)
Opening shareholders' deficit	**(514.0)**	(384.5)
Closing shareholders' deficit	**(747.2)**	(514.0)

22. Cash flow from operating activities

Reconciliation of operating profit to net cash inflow from operating activities:

	2012 £m	2011 £m
Continuing operations		
Operating profit	**210.9**	113.0
Depreciation charge	**109.0**	105.0
Goodwill amortisation	**9.6**	9.5
Amortisation of deferred income	**(3.2)**	(2.8)
Profit on disposal of fixed assets	**(0.2)**	(0.8)
Decrease/(increase) in debtors	**10.8**	(6.5)
Decrease in creditors	**(27.6)**	(23.7)
Movement in provisions	**1.0**	(1.0)
Total net cash inflow from operating activities	**310.3**	192.7

Notes to the financial statements for the year ended 31 March 2012
continued

23. Analysis of net debt

	1 April 2011 £m	Cash flow £m	Non-cash changes £m	**31 March 2012 £m**
Bank overdraft	(7.3)	2.4	–	**(4.9)**
Debt due within one year:				
– Financial Instruments	(43.9)	–	(26.3)	**(70.2)**
Debt due after more than one year:				
– Bonds	(2,991.5)	(372.1)	(42.1)	**(3,405.7)**
– Bank loans	(168.3)	171.6	(0.3)	**3.0**
– Shareholders' loans	(533.6)	–	–	**(533.6)**
Onerous financial instruments	(156.6)	20.0	(13.6)	**(150.2)**
Other financial instruments	11.4	(7.8)	30.4	**34.0**
Short term deposits	45.8	37.2	–	**83.0**
	(3,844.0)	**(148.7)**	**(51.9)**	**(4,044.6)**

Short term deposits comprise short-term highly liquid investments with a maturity of three months or less.

Non-cash changes noted above represent fair value movements on financial instruments (see note 17) and interest incurred on index-linked bonds during the year which has not been paid and has been included within the carrying value of amounts borrowed.

24. Operating lease commitments

The Group has lease agreements in respect of properties for which the payments extend over a number of years.

	2012 £m	2011 £m
Annual commitments under non-cancellable operating leases expiring:		
Within one year	**–**	–
Within two to five years	**–**	–
After five years	**0.5**	0.5
	0.5	0.5

The Company has no operating lease commitments in either year.

25. Capital commitments

Capital projects contracted for by the Group but not provided in the financial statements amounted to £10.1m at 31 March 2012 (2011: £20.4m). The Company has no capital commitments at 31 March 2012 (2011: £nil).

26. Pension commitments

A significant proportion of the Group's employees are members of the Scotia Gas Networks Pension Scheme ('the Scheme'). The Scheme provides final salary defined benefits for employees who joined the Lattice Group Scheme prior to 31 March 2002. A defined contribution section was added to the Lattice Group Scheme from 1 April 2002 for employees joining the Lattice Group Scheme from that date. Employees of the Group who were previously members of the Lattice Group Scheme transferred to the Scotia Gas Networks Pension Scheme on 1 December 2005.

a) Defined benefit scheme
The Scheme is operated by the Group and is funded with assets held in separate trustee administered funds. It is subject to independent valuations at least every three years, on the basis of which the qualified actuary determines the rate of employers' contribution, which, together with the specified contributions payable by the employees and proceeds from the scheme's assets, are expected to be sufficient to fund the benefits payable under the scheme.

The latest full actuarial valuation was carried out as at 31 March 2009. In accordance with FRS 17, a limited actuarial review has been carried out by Hymans Robertson at 31 March 2012 using the projected unit method.

The following financial assumptions have been used:

As at 31 March

	2012	2011	2010	2009
Discount rate	**4.6% p.a.**	5.5% p.a.	5.5% p.a.	6.7% p.a.
Inflation assumption	**3.2% p.a.**	3.5% p.a.	3.7% p.a.	3.0% p.a.
Rate of increase of salaries	**4.7% p.a.**	5.0% p.a.	5.2% p.a.	4.5% p.a.
Rate of increase of pensions payment	**3.2% p.a.**	3.5% p.a.	3.7% p.a.	3.0% p.a.

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 expectancy in years for a member once they reach age 65 is as follows:

As at 31 March

	2012		2011		2010	
	Male	**Female**	Male	Female	Male	Female
Member currently aged 65	**21**	**24**	21	23	21	23
Member currently aged 45	**25**	**28**	24	27	24	27

The fair value of the assets in the scheme, the present value of the liabilities in the scheme and the expected rate of return were:

As at 31 March

	2012		2011		2010		2009		2008	
	Long term rate of return expected	**Value £m**	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m
Equities	**7.0%**	**258.3**	7.8%	279.5	8.0%	308.3	7.7%	194.7	8.0%	234.5
Government bonds	**3.3%**	**166.2**	4.3%	99.2	4.5%	50.7	4.2%	63.6	4.5%	71.5
Corporate bonds	**4.6%**	**166.2**	5.5%	134.3	5.5%	63.1	6.7%	30.2	6.9%	25.8
Property	**5.0%**	**40.3**	5.3%	36.3	5.5%	20.2	5.2%	12.4	5.5%	22.5
Cash	**1.9%**	**8.2**	1.5%	9.9	1.1%	26.6	2.2%	17.2	5.8%	14.6
Total market value of assets		**639.2**		559.2		468.9		318.1		368.9
Actuarial value of liabilities		**(749.2)**		(624.7)		(618.4)		(368.8)		(341.7)
(Deficit)/surplus in scheme		**(110.0)**		(65.5)		(149.5)		(50.7)		27.2
Related deferred tax asset/(liability)		**26.5**		17.2		41.9		14.2		(7.6)
Net pension (liability)/ asset		**(83.5)**		(48.3)		(107.6)		(36.5)		19.6

The expected return on scheme assets represents the expected return of each major class of assets in which the scheme invests. Expected yield on fixed interest instruments are based on gross redemptions yields at the balance sheet date. Expected return on equity interests reflect real rates of return experienced in the relevant markets.

Notes to the financial statements for the year ended 31 March 2012
continued

26. Pension commitments (continued)

Movement in fair value of scheme assets

	2012 £m	2011 £m
At 1 April	**559.2**	468.9
Expected return on scheme assets	**36.6**	34.4
Contributions from scheme members	**1.7**	1.7
Contributions from the Company	**44.3**	64.4
Actuarial gains/(losses)	**6.5**	(3.3)
Benefits paid	**(9.1)**	(6.9)
As at 31 March	**639.2**	559.2

Movement in fair value of scheme liabilities

	2012 £m	2011 £m
At 1 April	**(624.7)**	(618.4)
Service cost	**(21.6)**	(22.7)
Interest cost	**(34.7)**	(34.5)
Contributions from scheme members	**(1.7)**	(1.7)
Actuarial (losses)/gains	**(75.6)**	45.7
Benefits paid	**9.1**	6.9
At 31 March	**(749.2)**	(624.7)

The Group's contribution rate during the year was 37.3% of pensionable earnings. Additionally, the Group made special pension contributions to repair the deficit amounting to £23.5m. The expected contributions to be made in the year to 31 March 2013 are 37.3% of pensionable salary.

The actual gain on scheme assets was £43.1m (2011: £31.1m).

The cumulative amount of actuarial losses recognised in the statement of total recognised gains and losses since the adoption of FRS 17 is £137.4m (2011: £68.3m).

Analysis of the amounts recognised in the profit and loss account

	2012 £m	2011 £m
Amount charged to operating profit:		
Current service cost	**(21.6)**	(22.7)
Analysis of the amount credited to finance income:		
Expected return on pension scheme assets	**36.6**	34.4
Interest on pension scheme liabilities	**(34.7)**	(34.5)
Net finance credit/(charge) (see notes 6 and 7)	**1.9**	(0.1)
Net charge to the profit and loss account	**(19.7)**	(22.8)

Analysis of the amount recognised in the statement of total recognised gains and losses (STRGL)

	2012 £m	2011 £m
Actuarial gains/(losses) on scheme assets	**6.5**	(3.3)
Actuarial (losses)/gains on obligation	**(75.6)**	45.7
Deferred tax	**14.3**	(11.6)
Actuarial (loss)/gain recognised in STRGL	**(54.8)**	30.8

History of experience gains and losses

	2012	2011	2010	2009	2008
Fair value of plan assets	**639.2**	559.2	468.9	318.1	368.9
Present value of defined benefit obligation	**(749.2)**	(624.7)	(618.4)	(368.8)	(341.7)
(Deficit)/surplus	**(110.0)**	(65.5)	(149.5)	(50.7)	27.2
Experience adjustments on scheme assets	**£6.5m**	(£3.3m)	£98.1m	(£82.8m)	(£36.8m)
– Percentage of scheme assets at year end	**1.0%**	(0.6%)	20.9%	(26.0%)	(10.0%)
Experience adjustments on scheme liabilities	**£13.0m**	£15.6m	(£20.7m)	–	–
– Percentage of the present value of scheme liabilities at year end	**1.7%**	2.5%	(3.3%)	–	–
Total actuarial (losses)/gains on obligation	**(£75.6m)**	£45.7m	(£213.8m)	£8.1m	£75.8m
– Percentage of the present value of scheme liabilities at year end	**(10.1%)**	7.3%	(34.6%)	2.2%	22.2%

Movement in deficit during the year

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Deficit in scheme at start of year	**(65.5)**	(149.5)	(50.7)	–	(67.0)
Movement in year:					
– Current service costs	**(21.6)**	(22.7)	(14.2)	(13.5)	(18.4)
– Contributions	**44.3**	64.4	34.5	34.5	34.2
– Other finance (expense)/income	**1.9**	(0.1)	(3.4)	3.0	2.6
– Actuarial gain/(loss)	**(69.1)**	42.4	(115.7)	(74.7)	75.8
Restriction of recognised surplus	**–**	–	–	–	(27.2)
Deficit in scheme at end of year	**(110.0)**	(65.5)	(149.5)	(50.7)	–

b) Defined contribution schemes

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

	2012 £m	2011 £m
Amount charged in respect of defined contribution schemes	**2.1**	2.0

27. Related parties

The Company is owned by a consortium consisting of Scottish and Southern Energy plc (50%), OTPPB Investments (UK) Limited (25%), which is owned by Ontario Teachers' Pension Plan Board and Borealis Infrastructure Europe (UK) Limited (25%), which is indirectly wholly owned by OMERS Administration Corporation.

It is the opinion of the Directors that the Group and Company have no single controlling party as the Company is controlled jointly by the consortium.

Notes to the financial statements for the year ended 31 March 2012
continued

27. Related parties (continued)

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

	Group	
	2012 £m	2011 £m
Shareholders' loans:		
SSE plc	**266.8**	266.8
Borealis (Luxembourg) SCA (1)	**133.4**	133.4
OTPPB Investments (UK) Limited	**133.4**	133.4
	533.6	533.6
Interest owed to shareholders:		
SSE plc	**11.3**	11.3
Borealis (Luxembourg) SCA	**5.7**	5.7
OTPPB Investments (UK) Limited	**5.7**	5.7
	22.7	22.7
Other amounts owed to shareholders:		
SSE plc	**6.3**	16.1

(1) Borealis (Luxembourg) SCA is an affiliate of Borealis Infrastructure Europe (UK) Limited.

The aggregate interest expense charged to the profit and loss account in respect of shareholders' loans was £66.7m (2011: £66.7m). Interest accrues on the shareholders' loans at a fixed rate of 12.5% per annum and is payable semi-annually in arrears on 30 November and 31 May each year. The Company may, upon giving due notice, elect to pay some or all of the interest payable through the issuance of further loans to its shareholders.

Other than interest charges relating to shareholder loans, the following transactions took place during the year between the Group and the SSE plc group of companies (SSE).

	2012 £m	2011 £m
Sales of goods and services	**154.3**	131.2
Purchase of goods and services	**(62.9)**	(62.4)
Sale of tax losses	**1.1**	5.6

Sales of goods and services to SSE primarily represent gas transportation services. At 31 March 2012 an amount of £13.9m (2011: £12.1m) was owed by SSE in relation to these services and is included within trade debtors.

SSE provides services to the Group in the form of a management services agreement for corporate services. The Group also purchases certain items such as consumables stock, shrinkage gas and public liability insurance from SSE. Included within purchases of goods and services are direct costs in relation to tangible fixed asset and acquisitions projects incurred by SSE which have been recharged to the Group and capitalised. These costs amounted to £0.6m (2011: £0.6m).

During the year, the Group surrendered gross tax losses of £36.6m to SSE (2011: £55.4m) relating to the year ended 31 March 2010 for an aggregate cash consideration of £1.1m (2011: £5.6m).

Designed and produced by Tayburn

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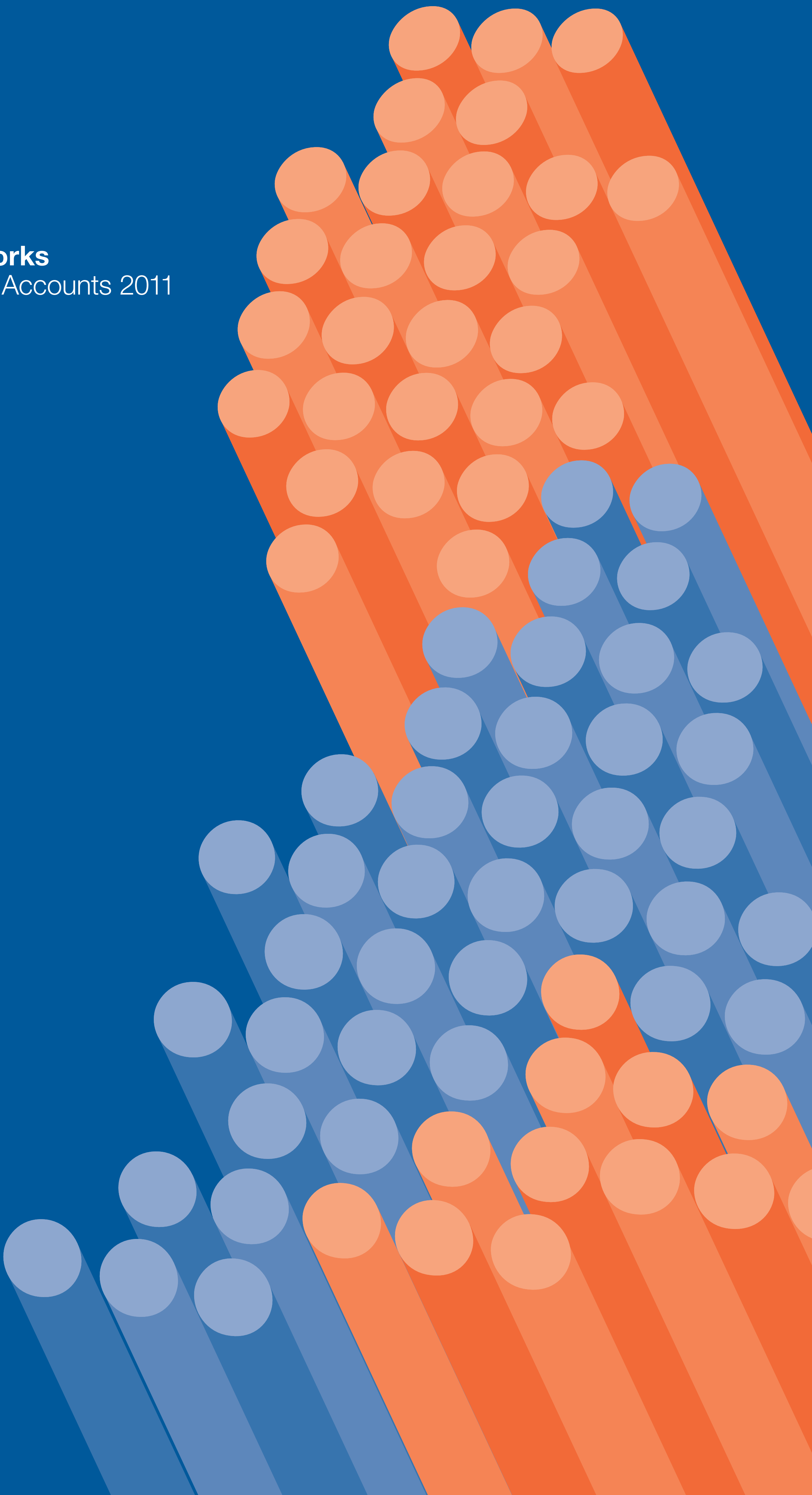
Scotia Gas Networks Annual Report and Accounts 2011

Scotia Gas Networks
Annual Report and Accounts 2011



Scotia
Gas Networks

Contents

RAV (Regulated Asset Value)

£4.3bn

March 2011

Gas Company of the Year 2010
IGEM/sbgi Gas Industry Awards

Scotia Gas Networks Limited (the "Company") is a holding company which does not trade. This operating and financial review sets out the main trends and factors underlying the development and performance of the Company and its subsidiary undertakings (together the "Group") during the year ended 31 March 2011 as well as those matters which are likely to affect its future development and performance.

The Directors, in preparing this operating and financial review, have sought to comply with the Accounting Standard Board's 2006 Reporting Statement: Operating and Financial Review as far as it applies to the circumstances of the Group.

Financial and operational highlights

Ofgem DRS Awards

£2.95m

Leading Gas Distribution Network 2009-2011: Reward for safety, fuel poverty and environmental initiatives

Network investment

£399m

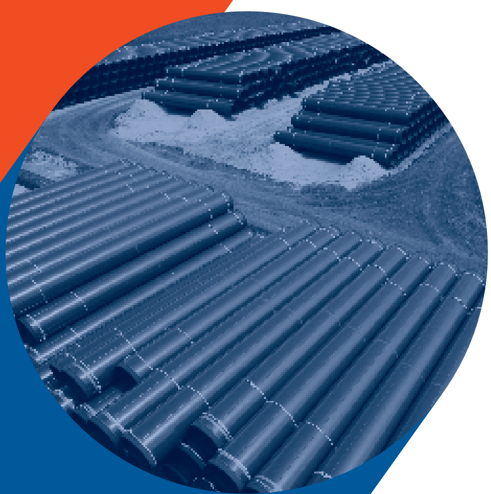
Capital and replacement expenditure in 2010/11

Biogas

1st

First UK Biogas plant at Didcot

Overall Safety Achievement Award
GISG 2011
Winner



Our business at a glance

Regulated by Ofgem, the Group operates gas transportation and distribution networks in Scotland and the south and south-east of England.

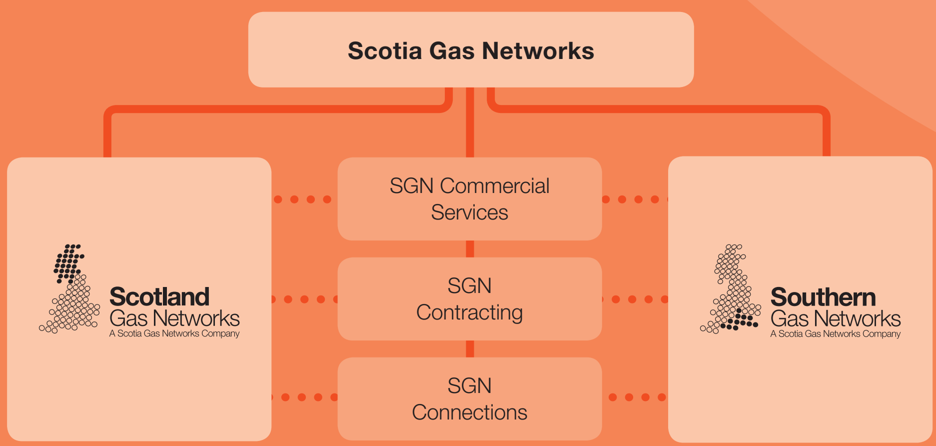
Our focus

The Group's principal objectives are:
- to deliver natural gas safely, reliably and efficiently across the gas distribution networks
- to provide the highest standard of service to our customers
- to deliver value to our shareholders.

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

Our structure

Scotia Gas Networks
The Company is owned by three shareholders including SSE plc (50%), Borealis Infrastructure Europe (UK) Limited (25%) which is indirectly wholly owned by OMERS Administration Corporation and OTPPB Investments (U.K.) Limited (25%) which is owned by Ontario Teachers' Pension Plan Board.



Our vision

To be the leading operator of gas networks in the UK

Our operations throughout the UK

Our Scottish network distributes gas across all of Scotland to 75% of households, including remote areas through the Scottish Independent Undertakings (SIU) at Stornoway, Wick, Thurso, Oban and Campbeltown.

Our Southern 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, distributing gas to around 90% of households.

SGN gas network areas

The scale of our business

The Group operates the regulated gas transportation networks in Scotland and the south and south-east of England and two of eight regional gas distribution networks in the United Kingdom.

5.8 million

5.8 million domestic, commercial and industrial customers in the Southern region and throughout Scotland

74,000km

74,000km of gas mains delivering natural gas throughout our regions

3,921

3,921 full-time employees at 31 March 2011 (2010: 3,996)

Our values

Our values underpin everything we do.

Safety

We all take **responsibility** for our own safety and for the safety of others

Performance

We strive for commercial success through **efficiency**, continuous improvement and innovation

People

We work and develop together with **honest** communication and respect

Customers

We listen to and understand our customers' needs, deliver a **quality** service and keep our promises

Our world

We show through our actions that we **care** about the world and the communities around us

Operational review

The winter of 2010/11 was the worst for several decades. The weather brought with it many operational challenges across both of the Group's gas network areas with some of the coldest temperatures being recorded since records began in 1910 and snow bringing transport networks to a standstill. The impact of the extreme cold weather and significant snowfall had severe restrictions on mobility and significantly impacted on the emergency service provided by the Group's First Call Operatives (FCOs).

However, despite the extreme conditions, the gas network stood up very effectively and the efforts of staff and contractors to meet the Group's standards of service and generally look after its customers was exceptional.

£21m

During the year the Group commenced its £21m project to replace three high pressure gas pipelines from the mainland to the Isle of Wight.

A landmark project at Didcot in Oxfordshire with partners Thames Water and Centrica saw, for the first time in the UK, gas produced from human waste safely introduced to the gas network. This biogas was previously flared to atmosphere and the energy wasted, but the project at Didcot cleans and enriches the biogas before injecting it into the existing gas network. The plant marks an important milestone in the UK's efforts to de-carbonise the gas grid and move towards a low-carbon economy, with expertise provided by the Group's engineers to get the gas connected to the network and the related onsite infrastructure.

It is hoped this will be the first of many similar projects and is a demonstration of utility companies from different sectors working well together. Gas has been delivered to customers in its traditional form for many years, but this project demonstrates how biomethane can offer a unique, green solution to heating homes for decades to come and is recycling at its very best.

Didcot Biogas plant – recycling at its best.

During the year the Group commenced its £21m project to replace three high pressure gas pipelines from the mainland to the Isle of Wight. The old pipes were laid on the seabed of the Solent and were replaced with two new 300mm (12") diameter steel pipelines installed under the seabed using Horizontal Directional Drilling (HDD) techniques. The drilling and pipe installation works were completed in early 2011, exceeding a distance of 3.9km.

In the course of the project, a number of public exhibitions and meetings were held to engage with local people and groups. At the same time, safety and environmental standards were managed to exceptional levels, with no significant injuries and no environmental incidents occurring during the course of the project. In addition, the SGN Project Manager was awarded the accolade of Gas Industry Manager of the Year at the 2011 IGEM/sbgi award ceremony, being cited for her work on this project.

The Group carries out quarterly postal customer satisfaction surveys covering both planned (replacement) and unplanned (emergency and repair) work, which is used to further assess quality of service performance. The results of the surveys have been very encouraging and are highlighted on page 9. A programme of Commitment Based Management (CBM) techniques for customer-facing staff has been in operation for several months and the results are starting to show in the surveys.

Information systems
During the year, as part of a Back Office Replacement Programme, Oracle Financials went live on 1 June 2010. This system has enabled the business to analyse project activities across its operations as well as providing more detail about how resources are deployed. This has already seen improvements in the internal control environment and the provision of management information and work is ongoing to modify established processes to fully exploit the system's capabilities.

0.05

This year the Group has reduced its lost time injury performance rate to 0.05 injuries per 100,000 hours (2010: 0.06).

Safety
Injury performance

The Group'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 Group has reduced its lost time injury performance rate to 0.05 injuries per 100,000 hours (2010: 0.06).

The Group also achieved, once again, a Royal Society for the Prevention of Accidents Occupational Health and Safety gold award, which is awarded to recognise and celebrate the achievement of a very high standard of health and safety at work.

Taking responsibility for the safety of employees and the general public.

Our market

External and regulatory environment
The management and operation of the Group'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 Group 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 Group's activities as a gas transporter is the Gas Act 1986 (as amended). Under the Gas Act, the Group holds licences which allow it to operate the gas distribution networks it owns. Such businesses are regulated by Ofgem, which has established price control mechanisms that govern the amount of revenue that can be earned by regulated businesses, typically covering five year price control periods. Ofgem assesses the revenue and investment plans of the businesses in order to determine an efficient level of expenditure and the quality of service requirements for the networks are also taken into account. A cost of capital for the required investment in the networks is also determined.

The Group is also subject to safety legislation that 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.

Market climate
The UK is in a period where gas supply patterns are moving to a position where more reliance is placed on imported gas. The decline in UK continental shelf gas reserves and the UK energy policy taking cognisance of climate change is driving this shift towards greater use of imported gas.

Factors affecting the business
The Group's principal activity is the operation of highly complex infrastructure networks. As a consequence, there are a number of factors that may influence the development and performance of the business and the financial returns that can be achieved. The principal factors that influence the business are as follows:

- **Regulatory price controls**
  As outlined above, the prices that can be charged for the use of the Group's networks are determined in accordance with Regulator approved price controls. The outcome of the five-year review baselined the revenues that will be obtained over the five-year price control period from 2008 to 2013. In addition, targeted incentive schemes were introduced by the Regulator whereby the Group is able to earn additional revenues by outperforming the targets, or alternatively is penalised if the Group does not meet them.

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

- **Safety and reliability of the networks**
  The Group'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 Group's objective is to ensure gas is delivered as efficiently as possible through its networks. This allows the Group to limit price increases and improve its own financial performance.

- **Interest rates**
  The costs of financing the operations are affected by changes in interest rates as some of the Group'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.

Operational review (continued)

Gas mains replacement programme

The Group has, in agreement with Ofgem and the Health and Safety Executive (HSE), embarked on an extensive safety-led programme of gas mains replacement across its networks to replace all iron pipes that are located within 30 metres of any property, which includes the replacement of the individual services connecting the premises to the mains network.

Replacing old mains with new plastic pipes.

The Group has a considerable amount of work to carry out and appreciates that this will inevitably cause some disruption. However, the polyethylene pipes being placed in the ground now, if left undisturbed, have a lifespan of at least 80 years, so when the work is complete, customers can expect to enjoy greater security of supply for many years to come. During the year, the Group increased its investment in replacement activities to £256.0m, 4.6% up on the year ended 31 March 2010.

£256.0m

During the year, the Group increased its investment in replacement activities to £256.0m, 4.6% up on the year ended 31 March 2010.

The Group is committed to working closely with the local authorities and police to plan its work, so that the minimum amount of disruption is caused to residents, road users, businesses and traders. Wherever possible, the Group uses modern, minimum-dig techniques, which allow the laying of gas mains without digging long trenches in the road, causing less impact on the environment and on local communities.

97.2%

Despite the extreme winter conditions, the Group's engineers attended 97.2% of uncontrolled gas escapes within one hour, exceeding the Ofgem target.

Gas escapes standards of service

The Group'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. Despite the extreme winter conditions, the Group's engineers attended 97.2% of uncontrolled gas escapes within one hour, exceeding Ofgem targets.

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

Environment

The Group is committed to the protection and enhancement of the environment and consideration for the environment is a feature of all its business activities. New ways to minimise the environmental impact of its activities are constantly sought.

The Group constantly benchmarks its environmental performance, allowing it to identify new opportunities, share best practice and achieve continuous improvements. During the year a number of employee briefings, campaigns and training events were held with the specific aim of increasing employees' knowledge and awareness of environmental matters, as well as health and safety issues.

This process of continual development provides staff with the information and competence they need to recognise and manage the significant environmental issues, risks, incidents and opportunities with which they are faced, thereby proactively avoiding pollution to land, air or water and protecting or enhancing the environment.

As part of its commitment to the environment, the Group also works in partnership with conservation charities, schools and a wide range of community groups. The Safety, Health and Environmental Advisory Committee is also responsible for monitoring the Group's environmental performance and ensuring that the environmental policy statement is adhered to.

Keeping the gas flowing despite the harsh winter weather.

Targets for 2010/11 included reducing methane emissions through leakage and active pressure management, reducing paper usage in offices and operational sites, reducing commercial fuel usage and reducing impact on the environment through reusing excavated materials and reducing the use of virgin aggregate. Progress to date has been positive.

Taking advantage of our 150 year old gas holder overlooking the Oval, a banner was put up promoting awareness of the dangers of carbon monoxide and the need to get an alarm.

The Group is developing a dynamic environmental strategy and ten year plan which can be revised to meet changes in internal or external policy or public/industry expectations as and when necessary. In line with its ambition to achieve environmental excellence, the Group will go beyond legislative compliance by seeking to meet internationally accepted good practice wherever it operates. This is reflected in the retention of the ISO 14001 standard (environmental management system standard) which is recognition of continuously reducing the impact on the environment. The Group will be setting equally challenging environmental objectives and targets for 2011/12 in accordance with its environmental strategy and ten year environmental improvement plan.

ISO 14001

The group retains the ISO 14001 standard which is recognition of continuously reducing the impact on the environment.

Future developments

Regulation

Ofgem have issued a new regulatory framework for the price control period commencing April 2013. It is anticipated that the new price control period will be for eight years and will see a greater focus on innovation, incentives and outputs. Following extensive stakeholder engagements the Group will be submitting business plans to Ofgem in the autumn of 2011 as part of this process.

Principal risks and uncertainties

As well as the opportunities the Group 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:

- Regulatory price control treatments of certain costs and allowed regulatory rate of return on investments;
- Changes in laws or regulation affecting the business, for example environmental or health and safety law or regulation;
- Breaches of laws or regulation affecting the business, or breaches of licence conditions;
- Credit market conditions, including the availability and cost of financing and re-financing;
- Failure of the network or other critical non-network operations;
- Pension scheme funding requirements; and
- Changes in tax allowances or rates.

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 17 to 19.

Operational review (continued)

Investment

Longer-term priorities include continued major replacement investment to replace metallic mains with polyethylene mains, a programme which has been developed in consultation with the HSE and Ofgem. In addition, continued major investment to upgrade the gas network is expected in order to meet instances of peak demand. The efficient and economic delivery of this capital investment will further increase the Group's Regulated Asset Value (the regulated asset value attributed to each of the Distribution Networks by Ofgem).

Detailed planning in all capital projects.

Further details

Further details on the long-term development plans of Southern Gas Networks plc and Scotland Gas Networks plc can be found in their respective long-term development statements (published in accordance with Special Condition D3 of their Gas Transporter Licences) and available on the Group'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 plans which are required to ensure the continued operation of both networks in accordance with the Group's licence conditions.

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

Stephen Dowd
Chairman
26 July 2011

Stakeholders

The Group has a range of external stakeholders including gas customers, employees, suppliers and contractors, Ofgem, local government bodies and communities. The Group adopts an open and constructive approach, both in terms of the way it operates, the services it provides and the impact its activities have on each of its stakeholders.

The Group 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 Group matches eligible fund raising by individual members of staff.

Working in the community SGN staff give the centre of a music-based charity a complete make-over.

Key performance indicators

The Group 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:

EBITDA[1]

Earnings before interest, tax, depreciation and goodwill amortisation

2011

£227.5m

2010: £240.7m

Adjusted EBITDA[1]

EBITDA excluding replacement expenditure

2011

£483.5m

2010: £485.4m

Capital expenditure

Additions to tangible fixed assets

2011

£143.1m

2010: £167.9m

Replacement expenditure

The cost of planned maintenance of mains and services

2011

£256.0m

2010: £244.7m

Debt to RAV ratio[2]

The Group's debt to RAV ratio

2011

67.3%

2010: 67.0%

Employee lost time incidents

Incidents resulting in employees taking time off work (per 100,000 hrs worked)

2011

0.05

2010: 0.06

Customer satisfaction: planned interruptions

Results from customer satisfaction surveys (10 = very satisfied)

2011

7.9[3]

2010: 8.0[4]

Customer satisfaction: unplanned interruptions

Results from customer satisfaction surveys (10 = very satisfied)

2011

8.4[3]

2010: 8.3[4]

Escapes attendance

Proportion of uncontrolled escapes attended in one hour – percentage (target 97%)

2011

97.2%

2010: 97.9%

[1] EBITDA is a non-statutory measure and is calculated by adding back goodwill amortisation and depreciation to operating profit.

[2] RAV is defined as Ofgem Regulatory Asset Value of the Southern and Scotland networks plus additions in excess of current allowances expected to be recovered in future periods. Debt for the purposes of the Debt to RAV ratio excludes shareholders' loans and liabilities arising from derivative financial instruments. The percentages stated are as at 31 March 2011 and 31 March 2010 respectively.

[3] Based on customer satisfaction survey reports obtained for the nine month period ended 31 December 2010 for Southern Gas Networks plc and Scotland Gas Networks plc.

[4] Based on customer satisfaction survey reports obtained for the nine month period ended 31 December 2009 for Southern Gas Networks plc and Scotland Gas Networks plc.

In considering financial performance, the Group uses EBITDA and Adjusted EBITDA. EBITDA is calculated by adding back goodwill amortisation and depreciation, which are non-cash costs, to operating profit. Adjusted EBITDA is calculated by adding back goodwill amortisation, depreciation and 100% of replacement expenditure to operating profit. Replacement expenditure, which, under UK GAAP, is written off to the profit and loss account as it is incurred, improves the future safety and reliability of the networks through the replacement of older gas pipes with modern pipes. Ofgem treats 50% of projected replacement expenditure as recoverable during the year and 50% as recoverable over future years. Accordingly, the Group believes the use of these adjusted measures best illustrates the underlying performance of the business.

Financial review

The Group sets out below its financial review for the year ended 31 March 2011. The comparative figures presented are for the year ended 31 March 2010, as reported in the audited financial statements, unless otherwise stated.

Turnover for the year ended 31 March 2011 was £802.0m (2010: £783.4m). The majority of turnover was earned from charges for the provision of gas transportation capacity as well as revenue based upon gas volumes transported in the year.

Loss for the year before taxation amounted to £121.2m (2010: £52.9m) and loss for the year after taxation amounted to £102.2m (2010: £66.9m).

Adjusted EBITDA for the year ended 31 March 2011 was £483.5m (2010: £485.4m). Adjusted EBITDA is calculated by adding back goodwill amortisation of £9.5m (2010: £9.7m), depreciation of £105.0m (2010: £97.8m) and replacement expenditure of £256.0m (2010: £244.7m) to reported operating profit of £113.0m (2010: £133.2m).

On 13 October 2010, the Company paid an interim dividend of £60.0m (2010: £nil).

Capital expenditure during the year amounted to £143.1m (2010: £167.9m). 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 Group's operations are financed by a combination of equity and loans from shareholders, bank borrowings and long-term bonds. The Group'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 page 14.

As a matter of policy a minimum of 75.0% of debt, excluding shareholders' loans, is maintained at either fixed rates of interest or index-linked. In accordance with these policies, a target interest rate profile has been set for long-term borrowings, excluding shareholders' loans, of between 80 and 85% of borrowings at either fixed rate or index-linked. This target is kept under review from time to time. Interest rate swaps are used, where necessary, in order to achieve this desired profile.

At 31 March 2011, the Group's total debt (before issue costs), excluding shareholders' loans and liabilities arising from derivative financial instruments, amounted to £3,172.4m (2010: £3,122.0m) and the debt to RAV ratio was 67.3% (2010: 67.0%). Of the total long-term borrowings at 31 March 2011, excluding shareholders' loans and after taking into account the effect of interest rate swaps, 80.8% were at either fixed rates of interest or were index-linked (2010: 81.4%).

Dividend and capital reduction
During the year the Company paid a dividend of £60m (2010: £nil) following a share capital reduction exercise using the solvency statement procedure which is provided for private companies by sections 641 to 644 of the Companies Act 2006. This is further detailed in note 19.

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

In accordance with FRS 17 (Retirement benefits), the Group's balance sheet accounts for any pension asset or liability. The net pension liability as at 31 March 2011 was £48.3m (2010: £107.6m). Following the valuation carried out by scheme's actuary as at 31 March 2009, the Group agreed, with effect from 1 April 2010, to increase annual special pension contributions from £13.5m to £23.5m over the next fifteen year period to 31 March 2025 to repair the pension deficit, with £43.5m paid in the year to 31 March 2011. The Group'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 Group'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 Group.

During the year, the €365m floating rate bond was redeemed at par and the related euro to sterling swaps were settled. At 31 March 2011 the Group's committed undrawn revolving credit facility amounted to £110.0m (2010: £350.0m). This facility expires in October 2013. The Group secured additional loan financing in September 2010 of £250.0m from the European Investment Bank, of which £175.0m was drawn at 31 March 2011.

Net cash inflow from operating activities for the year amounted to £192.7m (2010: £230.2m). The decrease is principally due to the increased level of expenditure for mains replacement. The net cash outflow from returns on investments and servicing of finance was £193.4m (2010: £177.2m) with the increase being attributable to an increase in interest rates during the year and issue of new debt. Net cash outflow for capital expenditure and financial investment was £121.3m (2010: £165.0m) reflecting a decrease in capital expenditure during the year following completion of the Farningham Pipeline project last year. After taking into account movements in short term deposits and financing items, overdrafts increased by £0.8m in the year (2010: decrease of £6.4m).

Counterparty credit risk
The Group transacts with banks for the provision of interest rate and currency hedging transactions. The Group maintains a minimum credit rating requirement of "A" or equivalent with its counterparties, however it recognises that at times the market conditions for banks can be unusually tight.

At the year end the Group had £11.4m receivable and £200.5m payable relating to financial instruments with bank counterparties.

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

Accounting policies
The Group'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 and, as previously highlighted in this report, operating profit is stated after writing off replacement expenditure during the year.

Board of Directors

Stephen Dowd, Chairman
Stephen joined the Board of the Company in November 2006 and was appointed Chairman of SGN in May 2008. He is Senior Vice President (Infrastructure) at Ontario Teachers' Pension Plan Board.

Gregor Alexander, Director
Gregor joined the Board of the Company at its inception and is also the Chairman of the Audit Committee. He is Finance Director of SSE plc and previously worked with the accountancy firm Arthur Andersen.

Registered office
St Lawrence House
Station Approach
Horley, Surrey
RH6 9HJ

Registered auditors
Deloitte LLP
Chartered Accountants
London

Registered Number:
04958135

Robert McDonald, Director
Robert joined the Board of the Company in July 2006. He is Managing Director Regulation and Strategy at SSE plc and has previously worked with the industry's regulatory body. Robert is a member of the Audit Committee.

James McPhillimy, Director
James joined the Board of the Company at its inception. He is Managing Director Group Services at SSE plc. James is Chairman of the Safety, Health and Environmental Advisory Committee and a member of the People and Reward Committee.

Sebastien Sherman, Director
Sebastien joined the Board of the Company in March 2007. He is Senior Vice President at Borealis Infrastructure Management Inc. He is a member of the Audit Committee and the Safety, Health and Environmental Advisory Committee.

Olivia Steedman, Director
Olivia joined the Board of the Company in July 2008. She is a Vice President at Ontario Teachers' Pension Plan Board and is a member of the Audit Committee.

Colin Hood, Director
Colin joined the Board of the Company at its inception and was its Chairman from 2005 until 2008. He is Chief Operating Officer of SSE plc and is also a Fellow of the Institute of Engineering and Technology. Colin is a member of the People and Reward Committee.

Michael Rolland, Director
Michael is President & Chief Executive Officer of Borealis Infrastructure Management Inc. He is a Chartered Accountant having previously worked with an international accounting firm. Michael is Chairman of the People and Reward Committee.

John Morea, Chief Executive Officer
John joined the Company in May 2005 from Scottish and Southern Energy plc where he was Director of Distribution having previously been Head of Operations for Southern Electric plc. He has extensive experience of electricity distribution, managing business change and delivering significant improvements in business efficiency. He has twice taken distribution companies to the efficiency frontier, with Southern Electric plc in 1999 and SSE plc in 2004. John has over 20 years experience within the utilities industry. He 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. He spent the previous 11 years with United Utilities where he was Finance Director of United Utilities Contract Solutions between 2003 and 2007. From 2007, Chris was 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.

John Morea and Chris Brook are the senior managers who attend board meetings.

Directors' report

The Directors present their report and the audited consolidated financial statements for the year ended 31 March 2011. The financial statements consolidate the financial statements of the Company and its subsidiary undertakings (together the "Group").

Principal activities

The Company is a holding company which does not trade.

The subsidiary undertakings principally affecting the profits or net assets of the Group in the year are listed in note 13 to the financial statements.

The Group's principal activity is the development, administration, maintenance and safe operation of the Southern and Scotland regional gas distribution systems and the supply of associated transportation, connection and metering services. It will continue these activities for the foreseeable future.

Directors

The Directors of the Company who served during the year ended 31 March 2011, all of whom have been Directors for the whole of the year, are listed below:

Gregor Alexander
Stephen Dowd (Chairman)
Colin Hood
Robert McDonald
James McPhillimy
Michael Rolland
Sebastien Sherman
Olivia Steedman

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, the Company 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 Group are set out in the Operational and Financial Review on pages 4 to 11.

Results and dividends

The consolidated profit and loss account is set out on page 21 and is reviewed on pages 10 and 11. The Group paid an interim dividend of £60.0m (2010: £nil) in October 2010. The Directors do not recommend the payment of any final dividend for the year (2010: £nil).

Financial risk management

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

Interest rate risk

The Group 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. In accordance with this policy, a target interest rate profile has been set for long-term borrowings of between 80 and 85% of borrowings at either fixed rate or index-linked, excluding borrowings from shareholders. The Group uses interest rate swaps, where necessary, in order to achieve this desired profile.

Liquidity risk

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

Foreign exchange risk

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

Credit risk

Counterparty credit risks arising from financial derivatives are managed through the maintenance of financial limits, subject to a minimum credit rating of "A" or equivalent allocated by a recognised major ratings group. In respect of short term cash management, counter parties 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.

Pricing risk
The Group's gas transportation charges are subject to price control formulae set within the regulatory regime. The Group's maximum allowed revenue in a given price period is dependent upon a number of factors that are not known in advance (such as actual transportation volumes and performance against incentives) 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 and incentive performance, 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.

Charitable contributions
The Group made charitable donations of £75,000 in the year (2010: £53,000) in support of community and employee initiatives across its operations. There were no political donations in either the current or prior year.

Employees
The Group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the Group. Participation by employees generally is encouraged through team meetings, briefings, an internal newspaper and an intranet site. The Chief Executive Officer and other senior executives regularly communicate with employees through these channels and 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 Group continues and that appropriate training and development is arranged. It is the policy of the Group that the training, career development and promotion of disabled persons should, as far as possible, be identical to that of other employees.

Creditors payment policy
The Group is committed to maintaining good commercial relationships with its creditors and suppliers and its current policy concerning payment is to:

- agree the terms of payment with those creditors/suppliers when agreeing the terms of each transaction;
- ensure that those creditors/suppliers were made aware of the terms of payment by inclusion of the relevant terms in contracts; and
- pay in accordance with its contractual and other legal obligations.

The payment policy applies to all payments to creditors/suppliers for revenue and capital supplies of goods and services without exception.

At 31 March 2011, the Group had an average of 29 days (2010: 35 days) outstanding in its trade creditors. The Company has not traded in either the current or prior year and accordingly has no trade creditors.

Going concern
The Group's financial position, cash flows, liquidity position and borrowing facilities together with the factors likely to affect its future performance and the Group's principal risks and uncertainties are set out in the Operational and Financial Review on pages 4 to 11. The Group's financial risk management objectives and risk exposures are set out above.

As stated in the Operational and Financial Review the Group operates the regulated gas distribution networks in South of England and Scotland. The revenue of the Group is regulated by Ofgem via established price control mechanisms based on the distribution network capacity. The Group has considerable financial resources together with committed financing facilities as discussed in Note 16 to finance the current and future operations. The Group's forecasts and projections, taking into account reasonably possible changes in trading performance, show that the Group should be able to operate within the level of its current facilities. As a consequence, the Directors believe that the Group 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 and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

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

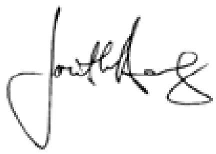
1) so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and

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 auditors are aware of that information.

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

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

By Order of the Board



Jonathan Adams
Company Secretary
26 July 2011

Statement of Directors' responsibilities

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). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

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

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

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

The Directors confirm to the best of their knowledge that:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole as at 31 March 2011; and
- the Directors' report includes a fair and true view of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of its principal risks and uncertainties.

Signed on behalf of the Board of Directors of Scotia Gas Networks Limited:

Stephen Dowd
Chairman
26 July 2011

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, being unlisted, is not subject to the UK Financial Reporting Council's UK Corporate Governance Code[1] (the "Governance Code") and the Board of Directors does not believe that all of the guidance set out in the Governance Code is applicable to the Company. However, for the purposes of this statement, the Directors have applied the Governance 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. It has overall responsibility for leading and controlling the Group as well as its financial and operational performance.

As a commercial joint venture, the composition of the Board reflects the shareholders' interests in the consortium. Each of the Directors is an employee of a shareholder or an affiliate of a shareholder of the Company. As the relationship of the shareholders is governed by a Shareholders' and Governance Agreement, any conflict of interest in the position of the Directors would be addressed in accordance with the provisions of the Shareholders' and Governance Agreement. Directors are nominated to the Board in accordance with the terms of the Shareholders' and Governance Agreement. The Directors have been briefed on the duties that have been conferred on them under the Companies Act 2006.

The powers of the Directors are set out in 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. This schedule is reviewed regularly. Furthermore, the Board has established three committees with specific responsibilities to ensure focused and effective leadership. Details of the committees are set out on page 18.

The Board meets regularly and held eight meetings during the year.

Board constitution and appointments

The Board 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.

Biographical details for each of the Directors are set out on page 12.

Chairman

Stephen Dowd was appointed as Chairman on 27 May 2008 for a three year period until the end of July 2011, succeeding Colin Hood.

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 12.

[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).

Corporate governance statement (continued)

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.

Directors' remuneration

The Directors did not receive any remuneration for their services to the Company, or to the Group, during the year ended 31 March 2011 or in the prior year. Accordingly, no further information requires to be disclosed.

Conflicts of interest

With effect from 1 October 2008, the Companies Act 2006 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 authorised each Director's reported actual and potential conflicts of interest at its meeting in September 2010.

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 committees with specific responsibilities. These are the Audit Committee, the People and Reward Committee and the Safety, Health and Environmental Advisory Committee, each of which meets regularly.

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.

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 in the table below.

Audit Committee

The current members of the Audit Committee are Gregor Alexander (Committee Chairman), Graham Laughland (appointed in 2009 as independent member of the audit committee), Sebastien Sherman, Robert McDonald and Olivia Steedman.

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 auditors 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.

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 3 times during the year.

Safety, Health and Environmental Advisory Committee

The current members of the Safety, Health and Environmental Advisory Committee are James McPhillimy (Committee Chairman), Stephen Dowd, Sebastien Sherman, John Morea (Chief Executive Officer) and Gary Barnes (Director of Safety, Customers and Human Resources).

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;

	Board meetings		Audit Committee meetings		People and Reward Committee meetings		Safety, Health and Environmental Committee meetings	
	Attended	Possible*	Attended	Possible	Attended	Possible	Attended	Possible
Gregor Alexander	6	6	3	3	–	–	–	–
Stephen Dowd	6	6	–	–	4	4	3	3
Colin Hood	6	6	–	–	4	4	1	1
Robert McDonald	6	6	3	3	–	–	–	–
James McPhillimy	6	6	–	–	4	4	3	3
Michael Rolland	6	6	–	–	4	4	–	–
Olivia Steedman	6	6	3	3	–	–	–	–
Sebastien Sherman	6	6	3	3	–	–	3	3

* In addition to the six bi-monthly meetings, there were two extraordinary meetings convened to approve EIB loan facility documentation. An extraordinary meeting's quorum consists of three Directors.

- 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 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 Michael Rolland (Committee Chairman), Stephen Dowd, Colin Hood and James McPhillimy.

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 Chairman 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. 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. Some areas for improvement were highlighted and these will be progressed during 2011/12. Performance of the Board and the Directors will continue to be reviewed on an annual basis.

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 period 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.

Independent auditors' report
to the members of Scotia Gas Networks Limited

Independent auditors' report to the members of Scotia Gas Networks Limited
We have audited the financial statements of Scotia Gas Networks Limited for the year ended 31 March 2011 which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the consolidated and Company balance sheets, the consolidated cash flow statement, the reconciliation of net cash flow to movement in net debt and the related notes 1 to 27. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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 auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors
As explained more fully in the Directors' Responsibilities Statements, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practice Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

Opinion
In our opinion the financial statements:

- give a true and fair view of the state of the Group's and the parent Company's affairs as at 31 March 2011 and of the Group's loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on matters prescribed in the Companies Act 2006
In our opinion the information in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been from branches not visited by us; or
- the parent Company 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.

Makhan Chahal

Makhan Chahal
(Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom
26 July 2011

Consolidated profit and loss account
for the year ended 31 March 2011

	Notes	2011 £m	2010 £m
Turnover	2	**802.0**	783.4
Net operating costs	3	**(689.0)**	(650.2)
Operating profit	3	**113.0**	133.2
Income from fixed asset investments	13	**0.6**	0.5
Interest receivable and similar income	6	**1.3**	2.0
Interest payable and similar charges	7	**(236.1)**	(188.6)
Loss on ordinary activities before taxation	4	**(121.2)**	(52.9)
Tax credit/(charge) on loss on ordinary activities	8	**19.0**	(14.0)
Loss for the financial year	20	**(102.2)**	(66.9)

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

Consolidated statement of total recognised gains and losses
for the year ended 31 March 2011

	Notes	2011 £m	2010 £m
Loss for the financial year	20	**(102.2)**	(66.9)
Cash flow hedges (net of deferred tax)	20	**1.9**	2.5
Actuarial gain/(loss) recognised on defined benefit pension scheme	26	**42.4**	(115.7)
Movement on deferred tax relating to pension scheme	26	**(11.6)**	32.4
Total recognised losses for the year		**(69.5)**	(147.7)

Balance sheets
as at 31 March 2011

	Notes	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Fixed assets					
Intangible assets – goodwill	11	**421.6**	431.1	**–**	–
Tangible assets	12	**3,504.2**	3,466.1	**–**	–
Investments	13	**0.2**	0.2	**948.4**	948.4
		3,926.0	3,897.4	**948.4**	948.4
Current assets					
Debtors	14	**64.8**	133.3	**80.9**	128.7
Short term deposits		**45.8**	138.3	**45.8**	138.3
		110.6	271.6	**126.7**	267.0
Creditors: amounts falling due within one year	15	**(285.9)**	(590.8)	**(365.3)**	(463.9)
Net current liabilities		**(175.3)**	(319.2)	**(238.6)**	(196.9)
Total assets less current liabilities		**3,750.7**	3,578.2	**709.8**	751.5
Creditors: amounts falling due after more than one year	16	**(3,693.4)**	(3,309.7)	**(533.6)**	(533.6)
Provisions for liabilities	18	**(392.5)**	(430.8)	**–**	–
Deferred income	12	**(130.5)**	(114.6)	**–**	–
Net (liabilities)/assets excluding pension liabilities		**(465.7)**	(276.9)	**176.2**	217.9
Defined benefit pension liabilities	26	**(48.3)**	(107.6)	**–**	–
Net (liabilities)/assets including pension liabilities		**(514.0)**	(384.5)	**176.2**	217.9
Capital and reserves					
Called up share capital	19	**200.0**	269.1	**200.0**	269.1
Hedge reserve	20	**(30.4)**	(32.3)	**–**	–
Profit and loss account	20	**(683.6)**	(621.3)	**(23.8)**	(51.2)
Shareholders' (deficit)/funds	21	**(514.0)**	(384.5)	**176.2**	217.9

The financial statements of Scotia Gas Networks Limited, registered number 04958135, were approved by the Board of Directors on 26 July 2011.

Signed on behalf of the Board of Directors

Stephen Dowd
Director

Gregor Alexander
Director

Consolidated cash flow statement
for the year ended 31 March 2011

	Notes	2011 £m	2010 £m
Net cash inflow from operating activities	22	**192.7**	230.2
Returns on investments and servicing of finance			
Interest paid		**(194.0)**	(177.8)
Interest received		**–**	0.1
Dividends received from fixed asset investments		**0.6**	0.5
Net cash outflow from returns on investments and servicing of finance		**(193.4)**	(177.2)
Taxation	27	**5.6**	–
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(140.8)**	(187.6)
Sale of tangible fixed assets		**0.8**	0.5
Customer contributions received	12	**18.7**	17.6
Refund on cost of investment	11	**–**	4.5
Net cash outflow for capital expenditure and financial investment		**(121.3)**	(165.0)
Equity dividends paid	10	**(60.0)**	–
Net cash outflow before management of liquid resources and financing		**(176.4)**	(112.0)
Management of liquid resources			
Decrease/(increase) in short term deposits	23	**92.5**	(104.4)
Net cash inflow/(outflow) from management of liquid resources		**92.5**	(104.4)
Financing			
Repayment of bonds	23	**(325.6)**	–
Settlement of swaps	23	**75.3**	–
Issue of bonds	23	**175.0**	419.1
Drawdown/(repayment) of bank borrowings	23	**170.0**	(180.0)
Payments in respect of financial instruments	23	**(11.6)**	(16.3)
Net cash inflow from financing		**83.1**	222.8
(Increase)/decrease in bank overdrafts	23	**(0.8)**	6.4

Reconciliation of net cash flow to movement in net debt
for the year ended 31 March 2011

	Notes	2011 £m	2010 £m
(Increase)/decrease in bank overdraft in the year		**(0.8)**	6.4
(Decrease)/increase in short term deposits		**(92.5)**	104.4
Movement in borrowings		**(83.1)**	(222.8)
Change in net debt resulting from cash flows	23	**(176.4)**	(112.0)
Other non-cash changes	23	**(30.0)**	1.7
Net debt at beginning of year		**(3,637.6)**	(3,527.3)
Net debt at end of year	23	**(3,844.0)**	(3,637.6)

Notes to the financial statements
for the year ended 31 March 2011

1. PRINCIPAL ACCOUNTING POLICIES

The financial statements have been prepared in accordance with applicable accounting standards in the United Kingdom and the Companies Act 2006.

The financial statements of the Group present the results for the year ended 31 March 2011. The comparative period presented is the year ended 31 March 2010.

A summary of the more significant Group accounting policies, which have been applied consistently in both years, is as follows.

Basis of preparation

These financial statements have been prepared under the historical cost convention except that assets and liabilities were stated at fair value when acquired and certain derivative financial instruments are also recorded at fair value.

The financial statements have been prepared on the going concern basis as set out in the Directors' Report.

Basis of consolidation

The financial statements consolidate the financial statements of the Company and its subsidiary undertakings drawn up to 31 March each year. Subsidiaries are those entities controlled by the Group or the Company.

Subsidiaries acquired are consolidated in the financial statements of the Group from the date that control commences until the date control ceases, using the acquisition method of accounting.

Intra-Group balances and any unrealised gains and losses or income and expenses arising from intra-Group transactions, are eliminated in preparing the consolidated financial statements.

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 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.

Replacement expenditure

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

Taxation

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

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more or a right to pay less tax in the future have occurred at the balance sheet date, with the following exceptions:

- provision is made for gains on disposal of fixed assets that have been rolled over into replacement assets only where, at the balance sheet date, there is a commitment to dispose of the replacement assets with no likely subsequent rollover or available capital losses;

- provision is made for gains on revalued fixed assets only where there is a commitment to dispose of the revalued assets and the attributable gain can neither be rolled over nor eliminated by capital losses; and

- deferred tax assets are recognised only to the extent that the Directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing difference can be deducted.

Deferred tax is measured on an undiscounted basis.

Intangible assets – goodwill

Goodwill is capitalised and amortised on a straight line basis to the profit and loss account over its expected useful life. Goodwill represents the excess of the fair value of the consideration paid for the acquisition of businesses over the fair value of the separable net assets acquired.

The useful life of goodwill related to acquired businesses has been estimated to be 50 years.

A review for impairment of goodwill is carried out at the end of each financial year. Impairment reviews comprise a comparison of the carrying amount of the goodwill with its recoverable amount (the higher of net realisable value and value in use). To the extent that the carrying amount exceeds the recoverable amount, the goodwill is impaired and an impairment loss is recognised in the profit and loss account.

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.

Tangible fixed assets
Tangible fixed assets are stated at cost less depreciation and any provision for impairment. The cost is the purchase cost of the asset, together with any directly attributable costs of acquisition. In respect of assets purchased as part of a business combination, the cost is the fair value of the assets acquired.

The carrying values of tangible fixed assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

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

Freehold buildings	Up to 50 years
Leasehold buildings	Over the shorter of lease term and 50 years
Plant and machinery:	
– Mains and services	60 to 65 years
– Regulating equipment	30 to 50 years
– Gas storage	40 years
Motor vehicles and office equipment	3 to 10 years

Grants and contributions
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. Deferred income in respect of revenue grants and contributions is included within creditors: amounts falling due within one year.

Finance leases
Assets held under finance leases, which confer rights and obligations similar to those attached to owned assets, are capitalised as tangible fixed assets and are depreciated over the shorter of the lease terms and their useful lives. The capital elements of future lease payments are recorded as liabilities, while the interest elements are charged to the profit and loss account.

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, except where the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate is shorter than the full lease term, in which case the shorter period is used.

Pensions
Defined benefit pension scheme
The amounts charged to the profit and loss account are the current service costs and gains and losses on settlements and curtailments. They are included within staff costs. Past service costs are recognised immediately in the profit and loss account if the benefits have vested. If the benefits have not vested immediately the costs are recognised over the period until vesting occurs. The interest cost and the expected return on the assets are shown as a net amount of other finance costs or credits within interest payable or receivable. Actuarial gains and losses are recognised immediately in the consolidated statement of total recognised gains and losses.

The defined benefit scheme is funded, with the assets of the scheme held separately from those of the Group, in separate trustee administered funds. Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date.

The resulting defined benefit asset or liability, net of the related deferred tax, is presented separately after other net assets on the face of the balance sheet. Any pension asset is recognised in the balance sheet to the extent that the benefits may be derived from the surplus in the form of reduced cash contributions in the future or cash refunds.

Notes to the financial statements (continued)
for the year ended 31 March 2011

1. PRINCIPAL ACCOUNTING POLICIES (continued)

Defined contribution pension schemes
The Group also operates defined contribution pension schemes. The assets of the schemes are held separately from those of the Group in independently administered funds. The amounts charged to the profit and loss account represent the contributions payable to the schemes in the period. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

Provisions
A provision is recognised in the balance sheet when the Group 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.

Financial instruments
The Group'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.

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).

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.

Impairment of financial assets
Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

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

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Derecognition of financial assets
The Group 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.

Trade debtors
Trade debtors are initially recognised at fair value. The carrying amount is reduced through the use of an allowance account. Appropriate allowances 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 allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

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

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

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 Group 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 group 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 Group's documented risk management or investment strategy and information about the Group is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives and IAS 39 Financial Instruments: Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL.

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.

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.

De-recognition of financial liabilities
The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire.

Derivative financial instruments and hedge accounting
The Group 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 Group 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 Group 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. Changes in fair value of derivatives that are designated and are effective as fair value hedges are recognised in the profit and loss account but effectively offset changes in fair value of the hedged item.

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.

Notes to the financial statements (continued)
for the year ended 31 March 2011

2. SEGMENTAL REPORTING

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.

3. OPERATING PROFIT AND NET OPERATING COSTS

	2011 £m	2010 £m
Turnover	**802.0**	783.4
Distribution costs	**(692.6)**	(653.1)
Profit on disposal of fixed assets	**0.8**	0.5
Other operating income	**2.8**	2.4
Total net operating costs	**(689.0)**	(650.2)
Operating profit	**113.0**	133.2

Distribution costs include the costs of operating the distribution network together with depreciation, goodwill amortisation and replacement expenditure.

4. LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION

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

	2011 £m	2010 £m
Auditors' remuneration	**0.3**	0.4
Goodwill amortisation	**9.5**	9.7
Depreciation of owned assets	**105.0**	97.8
Profit on disposal of fixed assets	**(0.8)**	(0.5)
Replacement expenditure	**256.0**	244.7
Impairment of trade debtors	**–**	(0.8)
Rentals under operating leases – other assets	**1.1**	1.4

Auditors' remuneration for the Group comprises £187,000 (2010: £178,000) in respect of statutory and regulatory audit services, £50,000 (2010: £50,000) in respect of other services pursuant to legislation, £nil (2010: £58,000) in respect of bond issue assurance work, £29,000 (2010: £125,000) in respect of IT consultancy services and £20,000 (2010: £nil) in respect of the capital reduction.

Auditors' remuneration in respect of statutory audit services for the Company amounted to £10,000 (2010: £10,000).

In addition to the above services, the Group's auditors acted as auditors to the Scotia Gas Networks Pension Scheme and fees of £15,000 (2010: £15,000) have been charged by the auditors to the Group in respect of these services.

5. EMPLOYEE INFORMATION AND DIRECTORS' EMOLUMENTS

The Group had 3,921 full time equivalent employees as of 31 March 2011 (2010: 3,996). The average monthly number of full time equivalent employees during the year was 3,993 (2010: 4,017).

The Directors did not receive any remuneration for their services to the Group during the year, or during the prior 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 Group.

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

	2011 £m	2010 £m
Staff costs		
Wages and salaries	**136.4**	131.6
Social security costs	**12.4**	11.5
Pension costs (see note 26)	**24.7**	16.1
	173.5	159.2

The Company had 9 employees as of 31 March 2011 (2010: 10).

6. INTEREST RECEIVABLE AND SIMILAR INCOME

	2011 £m	2010 £m
Interest receivable on short term deposits	**0.7**	0.4
Other finance income:		
Movement on financial derivatives (see note 17)	**0.6**	1.6
Total interest receivable and similar income	**1.3**	2.0

7. INTEREST PAYABLE AND SIMILAR CHARGES

	2011 £m	2010 £m
Bank loans	**0.2**	1.1
Index-linked bond interest	**54.1**	9.5
Other interest payable on bonds	**100.6**	92.6
Shareholders' loan interest (see note 27)	**66.7**	67.5
Other interest payable	**7.2**	5.5
Net pension charge (see note 26)	**0.1**	3.4
Unwind of discounts in provisions (see note 18)	**7.2**	9.0
	236.1	188.6

8. TAX CREDIT/(CHARGE) ON LOSS ON ORDINARY ACTIVITIES

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

	2011 £m	2010 £m
Current tax		
Corporation tax at 28%	**–**	–
Adjustment in respect of prior year	**5.6**	–
Total current tax credit	**5.6**	–
Deferred tax		
Deferred tax credit/(charge) for the year	**19.8**	(13.6)
Adjustments in respect of prior year	**(6.4)**	(0.4)
Total deferred tax credit/(charge) for the year	**13.4**	(14.0)
Total tax credit/(charge) on loss on ordinary activities	**19.0**	(14.0)

b) Factors affecting the current tax credit for the year

	2011 £m	2010 £m
Loss on ordinary activities before tax	**(121.2)**	(52.9)
Loss on ordinary activities multiplied by standard rate of corporation tax in the UK of 28%	**(33.9)**	(14.8)
Effects of:		
Non taxable income	**(0.2)**	(0.1)
Deferred tax on accelerated capital allowances	**(7.5)**	(10.7)
Deferred tax recognised on unutilised losses	**23.5**	1.5
Depreciation on non-qualifying assets	**8.0**	7.9
Other short term timing differences	**(10.9)**	(4.8)
Tax losses not recognised	**18.0**	18.0
Expenses not deductible for tax purposes	**3.0**	3.0
Adjustment in respect of prior year – proceeds from sale of tax losses	**(5.6)**	–
Current tax credit	**(5.6)**	–

The Emergency Budget on 22 June 2010 announced that the UK corporation tax rate will reduce from 28% to 24% over a period of four years from 2011. The March 2011 Budget reduced the UK corporation tax rate by a further 1% with the first reduction being from 28% to 26%. This was substantively enacted on 29 March 2011 and is effective from 2011. This will reduce the Group's future tax charge accordingly.

Notes to the financial statements (continued)
for the year ended 31 March 2011

8. TAX ON LOSS ON ORDINARY ACTIVITIES (continued)

As the rate change has been substantively enacted, it has the effect of reducing the Group's net deferred tax liabilities recognised at 31 March 2011 by £14.9m. It has not yet been possible to quantify the full anticipated effect of the announced further 3% rate reduction, due to legislation not being enacted, although this will further reduce the Group's future current tax charge and reduce the Group's deferred tax liabilities accordingly.

9. PROFIT OF THE COMPANY FOR THE FINANCIAL YEAR

The Company's loss for the year amounted to £18.3m (2010: Loss of £67.3m). In accordance with the exemption available under section 408 of the Companies Act 2006, no separate profit and loss account is presented in respect of the Company.

10. DIVIDENDS

	2011 £m	2010 £m
Equity shares		
Interim dividends paid of 12.7646 p (2010: pence nil)	**60.0**	–

11. INTANGIBLE FIXED ASSETS

Group

	Goodwill £m
Cost	
At 1 April 2010 and at 31 March 2011	**477.6**
Accumulated amortisation	
At 1 April 2010	46.5
Charge for the year	9.5
At 31 March 2011	**56.0**
Net book value	
At 31 March 2011	**421.6**
At 31 March 2010	431.1

The goodwill, which arose on the acquisitions of Scotland Gas Networks plc and Southern Gas Networks plc, 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 businesses acquired are 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 either the current or the prior year.

12. 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 2010	0.7	62.7	3,654.1	162.7	3,880.2
Additions	–	3.9	118.3	20.9	143.1
At 31 March 2011	**0.7**	**66.6**	**3,772.4**	**183.6**	**4,023.3**
Depreciation					
At 1 April 2010	0.1	5.3	362.4	46.3	414.1
Charge for the year	–	2.3	82.5	20.2	105.0
At 31 March 2011	**0.1**	**7.6**	**444.9**	**66.5**	**519.1**
Net book value					
At 31 March 2011	**0.6**	**59.0**	**3,327.5**	**117.1**	**3,504.2**
At 31 March 2010	0.6	57.4	3,291.7	116.4	3,466.1

The Company had no assets held under finance leases in the current or prior financial year.

The Company had no tangible fixed assets in either year.

The Group has received customer contributions relating to plant and machinery. In accordance with the Group's accounting policy the assets are capitalised within fixed assets and the contributions are recognised as deferred income in the balance sheet. 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:

Deferred income

	Group	
	2011 £m	2010 £m
Customer contributions brought forward	**114.6**	99.4
Customer contributions received in year	**18.7**	17.6
Amortisation in year	**(2.8)**	(2.4)
	130.5	114.6

The Company has no deferred income.

13. FIXED ASSET INVESTMENTS

Cost and net book value

	Group £m	Company £m
Shares in Group undertakings		
At 1 April 2010 and at 31 March 2011	–	948.4
Other investments		
At 1 April 2010 and at 31 March 2011	0.2	–
	0.2	**948.4**

Notes to the financial statements (continued)
for the year ended 31 March 2011

13. FIXED ASSET INVESTMENTS (continued)

Other fixed asset investments
Other fixed asset investments relate to the Group's investments in Xoserve Limited, which provides transportation transactional services on behalf of all the major gas network transportation companies. The Group holds 23.1% (2010: 23.1%) of the ordinary shares of Xoserve Limited.

During the year the Group received dividends of £0.6m (2010: £0.5m) in relation to this investment.

Interests in Group undertakings
Details of the principal subsidiary undertakings at the end of the year, which are directly wholly owned by the Company, are as follows:

Name of subsidiary	Description of shares held	Country of registration	Principal activities
Southern Gas Networks plc	160,174,772 ordinary shares of £1 each	England & Wales	Development, administration, maintenance and operation of regional gas distribution system and supply of transportation services.
Scotland Gas Networks plc	49,392,787 ordinary shares of £1 each	Scotland	Development, administration, maintenance and operation of regional gas distribution system and supply of transportation services.
SGN Contracting Limited	1 ordinary share of £1	England & Wales	Supply of contracting services.
SGN Connections Limited	1 ordinary share of £1	England & Wales	Supply of gas connections services.
SGN Commercial Services Limited	1 ordinary share of £1	England & Wales	Meter asset manager and supply of commercial services.

14. DEBTORS

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Amounts falling due within one year				
Trade debtors	**44.8**	37.6	**–**	–
Amounts owed by Group undertakings	**–**	–	**80.9**	126.8
Prepayments and accrued income	**8.6**	9.0	**–**	1.9
Derivative financial instruments (see note 17)	**11.4**	86.7	**–**	–
	64.8	133.3	**80.9**	128.7

Trade debtors are stated net of bad debt provisions of £0.3m (2010: £0.3m) and credit note provisions of £2.0m (2010: £2.3m).

Within amounts owed by Group undertakings are loans amounting to £80.9m (2010: £22.2m) which incur interest at 1.5% (2010: 1.5%).

15. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Bank loans and overdrafts	**7.3**	6.5	**–**	6.8
€365m floating rate loan note due 2010	**–**	324.8	**–**	–
Trade creditors	**38.0**	35.2	**–**	–
Amounts owed to Group undertakings	**–**	–	**342.8**	434.5
Other taxation and social security	**27.8**	19.3	**0.2**	0.3
Other creditors	**3.6**	3.1	**–**	–
Accrued interest	**61.2**	58.7	**22.3**	22.2
Other accruals	**85.5**	79.0	**–**	0.1
Deferred income	**18.6**	16.1	**–**	–
Derivative financial instruments (see note 17)	**43.9**	48.1	**–**	–
	285.9	590.8	**365.3**	463.9

The amount owed to Group undertaking represents loans which incur interest at 0.5% (2010: 0.5%).

16. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Bonds:				
Fixed rate and index-linked:				
£165m 2.127% index-linked due 2022	**194.5**	185.9	**–**	–
£250m 2.013% index-linked due 2035	**294.6**	281.6	**–**	–
£150m 2.066% index-linked due 2025	**176.8**	169.0	**–**	–
£15m 2.580% index-linked due 2028	**16.0**	15.2	**–**	–
£125m 2.31% index-linked due 2039	**133.3**	126.4	**–**	–
£257m 4.75% fixed rate due 2017	**255.7**	255.2	**–**	–
£300m 5.25% fixed rate due 2018	**298.1**	297.7	**–**	–
£225m 4.875% fixed rate due 2034	**224.3**	224.3	**–**	–
£215m 4.875% fixed rate due 2020	**214.3**	214.2	**–**	–
£375m 4.875% fixed rate due 2029	**373.5**	373.4	**–**	–
£225m 6.38% fixed rate due 2040	**223.5**	223.4	**–**	–
£25m 3.12% fixed rate due 2018	**25.0**	–	**–**	–
£25m 3.25% fixed rate due 2018	**25.0**	–	**–**	–
	2,454.6	2,366.3	**–**	–
Floating rates:				
£233m floating rate loan note due 2015	**232.6**	232.6	**–**	–
£100m floating rate loan note due 2015	**99.8**	99.8	**–**	–
£80m floating rate loan note due 2043	**79.5**	79.5	**–**	–
£75m floating rate loan note due 2018	**75.0**	–	**–**	–
£50m floating rate loan note due 2019	**50.0**	–	**–**	–
	536.9	411.9	**–**	–
Total bonds	**2,991.5**	2,778.5	**–**	–
Revolving credit facility drawn	**168.3**	(2.4)	**–**	–
Shareholders' loans (see note 27)	**533.6**	533.6	**533.6**	533.6
	3,693.4	3,309.7	**533.6**	533.6

The shareholder loans, which are subordinated, are redeemable at par on 31 May 2015, or may be redeemed at par by the Company by giving due notice. Interest accrues at a fixed rate of 12.5% per annum and the Company may, upon giving due notice, elect to pay some or all of the interest payable through the issuance of further loans to shareholders.

The total revolving credit facility is £280.0m and expires in November 2013.

Maturity of borrowings

	Group	
	2011 £m	2010 £m
Due within one year	**–**	324.8
Between one and five years	**1,034.3**	–
After five years	**2,659.1**	3,309.7
	3,693.4	3,634.5

The Company's borrowings fall due in more than five years.

The above borrowings are unsecured and are stated after the deduction of unamortised issue costs of £12.6m (2010: £14.5m). 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 2011 is £112.5m (2010: £75.5m).

Notes to the financial statements (continued)
for the year ended 31 March 2011

17. FINANCIAL INSTRUMENTS

The Group's funding, liquidity and exposure to interest rate, foreign currency exchange and credit risks are managed within a frame work 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 Treasury function is responsible for managing banking and liquidity requirements of the Group, risk management relating to interest rate and foreign exchange exposures and for managing the credit risk relating to banking counterparties with which it transacts. The function's operations are governed by policies determined by the Board.

Categories of financial instruments

The categories of financial assets and liabilities held by the Group were as follows:

	Book Value	
	2011 £m	2010 £m
Financial assets held at amortised cost		
Trade debtors (1)	**44.8**	37.6
Short term deposits (1)	**45.8**	138.3
	90.6	175.9
Financial assets at fair value		
Derivative financial instruments in designated hedging relationships (2)	**–**	76.3
Derivative financial instruments through the profit and loss account	**11.4**	10.4
	11.4	86.7
Available for sale financial assets (1)	**0.2**	0.2
Total financial assets	**102.2**	262.8

(1) The carrying amount of financial assets approximates to their fair value.

(2) During the year the Euro currency Swaps expired and were settled resulting in no gain or loss.

	Book Value	
	2011 £m	2010 £m
Financial liabilities held at amortised cost		
Trade creditors	**38.0**	35.2
Accrued interest	**61.2**	58.7
Other accruals	**85.5**	79.0
Bank loans and overdrafts	**175.6**	6.5
Bonds	**2,991.5**	2,778.5
Shareholder loans	**533.6**	533.6
	3,885.4	3,491.5
Financial liabilities at fair value		
Bonds	**–**	324.8
Derivative financial instruments in designated hedging relationships	**43.9**	48.1
Onerous contract swaps	**156.6**	171.1
	200.5	544.0
Total financial liabilities	**4,085.9**	4,035.5

The carrying amount of financial liabilities approximates to their fair value.

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1: Valued using unadjusted quoted prices in active markets for identified financial instruments.
- Level 2: Valued using techniques based significantly on observable market data. Instruments in this category are valued using valuation techniques where all of the inputs that have a significant impact on the valuation are directly or indirectly based on observable market data.
- Level 3: Instruments in this category have been valued using a valuation technique where at least one input (which has a significant input on the financial instruments' valuation) is not based on observable market data. Where inputs can be observed from market data with not undue cost and effort, the observed input is used. Otherwise management determines a reasonable estimate for the input.

An analysis of financial assets and liabilities that are recorded at fair value at 31 March 2011 is as follows:

2011	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
At fair value through profit and loss				
– other financial assets (derivatives)	–	11.4	–	11.4
	–	**11.4**	**–**	**11.4**
Financial liabilities				
At fair value through profit and loss				
– other financial liabilities (derivatives)	–	156.6	–	156.6
Derivatives used for hedging	–	43.9	–	43.9
	–	**200.5**	**–**	**200.5**

2010	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
At fair value through profit and loss				
– other financial assets (derivatives)	–	10.4	–	10.4
Derivatives used for hedging	–	76.3	–	76.3
	–	**86.7**	**–**	**86.7**
Financial liabilities				
At fair value through profit and loss				
– other financial liabilities (derivatives)	–	171.1	–	171.1
Derivatives used for hedging	–	48.1	–	48.1
Debt instruments	324.8	–	–	324.8
	324.8	**219.2**	**–**	**544.0**

Onerous contract swaps

In 2005 the Group entered into interest rate swap contracts to fix the Group's interest cost relating to (floating rate) bridging loans which were in place at the time. In October 2005, permanent long-term capital markets debt was issued to replace floating rate bridging loans. At that point these swaps became obsolete and consequently matching swaps were transacted (under which the Group received fixed rate interest) to close out the position. The crystallised loss was recognised in the profit and loss and a discounted provision equal to the market value of the matched swaps was established under onerous contract provision (see note 18). At 31 March 2011 the provision for onerous contract swap loss was £156.6m (2010: £171.1m).

Fair values

The Group's financial instruments recorded at amortised cost are shown below together with their fair values:

	31 March 2011		31 March 2010	
	Book Value £m	**Fair Value £m**	Book Value £m	Fair Value £m
Bonds	**2,991.5**	**3,168.3**	2,778.5	3,081.0
Shareholder loans	**533.6**	**545.4**	533.6	520.8
	3,525.1	**3,713.7**	3,312.1	3,601.8

Fair values of bonds and shareholder loans have been determined by reference to closing quoted market values where available or otherwise by discounting future cash flows at their market interest rate.

The carrying value of all other financial assets and liabilities approximates to their book value.

Notes to the financial statements (continued)
for the year ended 31 March 2011

17. FINANCIAL INSTRUMENTS (continued)

Risks
Exposure to counterparty credit risk, interest rate risk, currency risk and liquidity risk arise in the normal course of business. The extent of any exposures and the policies implemented to manage them are set out below:

Credit risk
Credit risk is the risk that a counterparty will default on its obligation resulting in financial loss to the Company.

The maximum exposure to credit risk is the carrying value of financial assets as follows:

	2011 £m	2010 £m
Net trade receivables	**44.8**	37.6
Financial derivative assets	**11.4**	86.7
Short term deposits	**45.8**	138.3
	102.0	262.6

Counterparty credit risks arising from financial derivatives are managed through the maintenance of financial limits, subject to a minimum credit rating of “A” or equivalent allocated by a recognised major ratings group. In respect of short-term cash management, counterparties are subject to review and approval according to defined criteria. The Group conducted a review of counterparty credit risk and concluded that no adjustment was required to reflect the net credit risk in arriving at the fair value of financial instruments stated in the balance sheet.

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.

Trade receivables from non-transportation income relates to consumers and businesses in relation to works for alterations, diversions, meters or damage repairs. In 2010/11 non-transportation receivables were 17.2% (2010: 21.0 %) of net trade receivables. An impairment allowance has been set aside according to the Group’s impairment policy.

The largest transportation debtor is £10.6m (2010: £11.9m). There is no material credit exposure to any one customer.

The ageing of trade receivables net of impairment allowance were:

	2011 £m	2010 £m
Not past due	**44.0**	37.2
Past due 0-30 days	**0.8**	0.4
Past due 31-90 days	**–**	–
Past due over 90 days	**–**	–
	44.8	37.6

The movement in the allowance for impairment of trade receivables was:

	2011 £m	2010 £m
Balance at 1 April 2010	**0.3**	1.1
Increase/(decrease) in allowance for impairment	**(0.1)**	(0.8)
Balance at 31 March 2011	**0.2**	0.3

In addition there are credit note provisions against trade debtors of £2.0m (2010: £2.3m).

The amount released of £0.1m is in respect of debtors 30 days past. None of the trade debtors that are past due or impaired have had their terms renegotiated.

The maximum exposure to credit risk at the reporting date is the fair value of each class of debtors mentioned above. The Company does not hold any collateral as security.

At the end of each reporting period a review of the provision for bad and doubtful debts is performed taking in to account the age, status and risk of recovery for each receivable.

Liquidity risk

Liquidity risk, the risk that the Group will have insufficient funds to meet liabilities as they fall due, is ultimately managed by the treasury function, which has defined an appropriate liquidity risk framework for the management of the Group's short, medium and long-term funding and liquidity requirements. The Group manages liquidity risk by maintaining adequate reserves, banking facilities and reserve borrowing facilities by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

The contractual maturity of the Group's financial assets and liabilities are shown in the following tables. The amounts shown are gross cash inflows/(outflows) with the exception of financial derivatives settled on a net basis where the amounts represent undiscounted net cash flows. When the amount payable is not fixed, the amount disclosed is determined by reference to relevant conditions existing at the reporting date.

2011

	0-6 months £m	6-12 months £m	1-2 years £m	2-5 years £m	> 5 years £m	Contractual cash flows £m	Interest/ discounting £m	Carrying value £m
Financial liabilities loans and borrowings								
Bank overdrafts	(7.3)	–	–	–	–	(7.3)	–	(7.3)
Bank loans	(5.1)	(5.1)	(20.4)	(170.0)	–	(200.6)	32.3	(168.3)
Shareholder loans	(33.4)	(33.4)	(66.8)	(678.6)	–	(812.2)	278.6	(533.6)
Bonds	(45.8)	(62.0)	(108.7)	(661.0)	(4,474.8)	(5,352.3)	2,360.8	(2,991.5)
	(91.6)	(100.5)	(195.9)	(1,509.6)	(4,474.8)	(6,372.4)	2,671.7	(3,700.7)
Derivative financial liabilities								
Hedging interest rate swaps	(8.8)	2.5	(6.2)	(16.0)	(80.7)	(109.2)	76.7	(32.5)
Onerous contract swaps	(9.9)	(9.9)	(19.7)	(56.0)	(89.2)	(184.7)	28.1	(156.6)
	(18.7)	(7.4)	(25.9)	(72.0)	(169.9)	(293.9)	104.8	(189.1)
Other financial liabilities								
Trade and Other payables	(38.0)	–	–	–	–	(38.0)	–	(38.0)
	(38.0)	–	–	–	–	(38.0)	–	(38.0)
Total financial liabilities	**(148.3)**	**(107.9)**	**(221.8)**	**(1,581.6)**	**(4,644.7)**	**(6,704.3)**	**2,776.5**	**(3,927.8)**

The Group expects to meets its obligations from cash balances, operating cash flows and re-financing.

The corresponding amounts for 2010 were as follows:

2010

	0-6 months £m	6-12 months £m	1-2 years £m	2-5 years £m	> 5 years £m	Contractual cash flows £m	Interest/ discounting £m	Carrying value £m
Financial liabilities loans and borrowings								
Bank overdrafts	(6.5)	–	–	–	–	(6.5)	–	(6.5)
Bank loans	–	–	–	–	–	–	–	–
Shareholder loans	(33.3)	(33.4)	(66.7)	(200.4)	(545.0)	(878.8)	345.2	(533.6)
Bonds	(45.3)	(312.2)	(109.4)	(330.7)	(4,725.9)	(5,523.5)	2,420.2	(3,103.3)
	(85.1)	(345.6)	(176.1)	(531.1)	(5,270.9)	(6,408.8)	2,765.4	(3,643.4)
Derivative financial liabilities								
Hedging interest rate swaps	(7.2)	2.8	(7.2)	(13.1)	(68.8)	(93.5)	55.8	(37.7)
Onerous contract swaps	(9.9)	(9.9)	(19.9)	(59.4)	(105.4)	(204.5)	33.4	(171.1)
	(17.1)	(7.1)	(27.1)	(72.5)	(174.2)	(298.0)	89.2	(208.8)
Other financial liabilities								
Trade and Other payables	(35.2)	–	–	–	–	(35.2)	–	(35.2)
	(35.2)	–	–	–	–	(35.2)	–	(35.2)
Total financial liabilities	**(137.4)**	**(352.7)**	**(203.2)**	**(603.6)**	**(5,445.1)**	**(6,742.0)**	**2,854.6**	**(3,887.4)**

Notes to the financial statements (continued)
for the year ended 31 March 2011

17. FINANCIAL INSTRUMENTS (continued)

Currency risk
The Group generally transacts in sterling denominated currency with the exception of certain material purchases and bond financing.

The Group enters into cross currency swap agreements from time to time with the effect of converting contractual commitments denominated in foreign currencies into sterling obligations. At 31 March 2011 the Group had minimal foreign currency exposure in relation to purchase contract commitments, or bond financing.

The Group redeemed the 365m Euro denominated floating rate bonds during the year (2010 carrying value: £324.8m) and the relevant Euro to Sterling swaps were settled.

Inflation risk
The Group's index-linked borrowings and interest liabilities are exposed to a risk of change in the carrying value due to changes in the UK Retail Price Index ('RPI'). This form of liability is a good match to the Group's regulated asset value which is also index-linked to RPI due to the price setting mechanism imposed by the regulator. The turnover capacity charges are also linked to RPI.

By matching liabilities and assets, index-linked debt hedges the exposure to changes in RPI and delivers cash flow benefit. The compensation for the inflation risk is recorded as payable on the balance sheet, with related principal as opposed to a cash payment. Assuming sensitivity to the RPI does not take into account the changes to revenue or operating costs that are affected by RPI or inflation generally, the following table shows the illustrative effect on the profit and loss account that would result from a 1% movement on movement in RPI before the effects of tax.

	£m
Impact on income statement	
Index-linked bonds accretion	**8.1**
Transportation income	**(7.4)**
Total	**0.7**

Interest rate risk
The Group limits the impact of interest rate risk by implementing a policy of 80-85% of borrowing being either at fixed or index-linked, excluding borrowing from shareholders. Derivative financial instruments are transacted to hedge risk in accordance with this policy.

The impact of a change in interest rates on financial derivatives is dependent on whether their designation is fair value through the profit or loss, or if designated as cash flow hedges then the impact will be through equity.

The following table represents the annualised impact (net of deferred tax) of 100 basis point change in short term interest rates at the reporting date in relation to equity and income statement. The analysis assumes that all other variables remain constant.

	2011 £m	2010 £m
Impact on income statement		
Floating rate instruments	**(7.1)**	(6.6)
Fixed to floating swaps	**(2.7)**	(1.9)
	(9.8)	(8.5)
Impact on equity		
Floating to fixed swaps	**3.6**	3.6

Cash flow hedges

Cash flow hedges comprise floating to fixed interest rate swaps of future interest payments relating to existing bonds. Receipts and payments for the swaps and the underlying bonds are exactly matched and in accordance with FRS 26 any gain or loss that is deferred to equity is recognised in profit or loss over the period that the floating rate interest payments impact on profit.

The movement before deferred tax taken to equity in respect of cash flow hedges in the year was £4.2m gain (2010: £3.1m loss). The hedge reserve movement is expected to unwind in profit or loss over the life of the swaps.

The notional principle amount of the outstanding cashflow hedges at 31 March 2011 was £363m (2010: £363m). At 31 March 2011 the fixed interest rates vary from 3.1% to 6.3% and floating rates 1.0% (Libor plus 140bp).

Fair value hedges

The Group has no fair value hedges at 31 March 2011.

The Group entered into cross currency swaps to hedge the fair value of €365m floating rate bonds. These swaps were designated as fair value hedge.

On 20 October, the €365m floating rate bond was redeemed at par and the related euro to sterling swaps were settled.

Movement in derivatives included in income statement

The net movement included within interest in the income statement for financial derivatives is as follows:

	2011 £m	2010 £m
Net fair value losses	**(7.6)**	(1.9)
Less: net amounts received	**8.2**	3.5
Net movement in financial derivatives	**0.6**	1.6

In addition the movement on onerous swap contracts in the period was £5.3 loss (2010: £7.2m) included in discount unwind within interest payable.

18. PROVISIONS FOR LIABILITIES

Group

	Onerous financial instruments £m	Environmental £m	Deferred tax £m	Other provisions £m	Total £m
At 1 April 2010	171.1	28.2	224.8	6.7	430.8
Arising during the year	–	0.2	–	1.0	1.2
Utilised during the year	(19.8)	(0.8)	–	(1.4)	(22.0)
Net movement in deferred tax	–	–	(24.6)	–	(24.6)
Amortisation of discount	5.3	1.8	–	–	7.1
At 31 March 2011	**156.6**	**29.4**	**200.2**	**6.3**	**392.5**

Onerous financial instruments

The onerous financial instruments provision relates to interest rate swap contracts which the Group holds (see note 17). The provision recorded at each balance sheet date represents the aggregate fair value of the swap contracts held. The provision will be utilised as cash settlement payments are made over the life of the swaps over the next seventeen years.

Environmental

The environmental provision represents the Directors' best estimate of environmental restoration costs, where the Group 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 estimated expenditure to settle the obligation. This provision is expected to be utilised over the next twenty years.

Notes to the financial statements (continued)
for the year ended 31 March 2011

18. PROVISIONS FOR LIABILITIES (continued)

Deferred tax
The net movement on the deferred tax provision has arisen as a result of a surrender of tax losses during the year, offset by other movements in the year of which £26.7m is recorded as a credit to the profit and loss account and £2.1m is recorded as a charge to the Statement of Total Recognised Gains and Losses.

The Company has no provisions in either year.

Deferred tax recognised in the financial statements (excluding deferred tax recognised in respect of pension liabilities – see note 26) is as follows:

	Group		Company	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Accelerated capital allowances	**(289.4)**	(303.9)	**–**	–
Deferred tax asset on losses	**66.4**	54.1	**–**	–
Deferred tax on cash flow hedges	**11.4**	13.5	**–**	–
Other timing differences	**11.4**	11.5	**–**	–
	(200.2)	(224.8)	**–**	–

The movement in provision for deferred tax is as follows:

	Group	
	2011 £m	2010 £m
At 1 April	**(224.8)**	(215.0)
Charged to profit and loss account	**26.7**	(9.1)
Charged to Statement of Recognised Gains and Losses	**(2.1)**	(0.7)
At 31 March	**(200.2)**	(224.8)

The Group has unrecognised deferred tax assets in respect of unutilised tax losses of £253.2m (2010: £221.7m). Deferred tax assets have been recognised in respect of tax losses to the extent that it is considered probable that these assets will be recovered. Deferred tax assets have not been recognised in respect of unutilised tax losses in the Company amounting to £65.8m (2010: £62.1m).

In accordance with FRS 19 ("Deferred tax"), deferred tax has been measured based upon a corporation tax rate of 26% (2010: 28%), being the tax rate substantively enacted at the balance sheet date.

Other provisions
This represents a provision for other legal and constructive obligations held by the Group. This provision is expected to be utilised over the next thirteen years.

19. SHARE CAPITAL

	31 March 2011		31 March 2010	
	Number	**Value (£m)**	Number	Value (£m)
Allotted, called up and fully paid shares				
'A' ordinary shares of 42.55p (2010: 57.25p) each	**235,025,002**	**100.0**	235,025,002	134.5
'B' ordinary shares of 42.55p (2010: 57.25p) each	**117,512,501**	**50.0**	117,512,501	67.3
'C' ordinary shares of 42.55p (2010: 57.25p) each	**117,512,501**	**50.0**	117,512,501	67.3
Total	**470,050,004**	**200.0**	470,050,004	269.1

The 'A', 'B' and 'C' ordinary shares rank pari passu in all respects.

On 7 October 2010, the Company reduced the nominal value of its issued, called and fully paid shares to 42.55p each. Consequently, the total value of called up share capital decreased by £69.1m.

20. RESERVES

	Hedge reserve		Profit and loss account	
	Group £m	Company £m	Group £m	Company £m
At 1 April 2010	(32.3)	–	(621.3)	(51.2)
(Loss)/profit for the financial year	–	–	(102.2)	18.3
Reduction of capital (see note 19)	–	–	69.1	69.1
Dividends paid on equity shares (see note 10)	–	–	(60.0)	(60.0)
Movement on cash flow hedges	3.9	–	–	–
Deferred tax on cash flow hedges	(2.0)	–	–	–
Actuarial gain on defined benefit pension scheme (net of related tax)	–	–	30.8	–
At 31 March 2011	**(30.4)**	**–**	**(683.6)**	**(23.8)**

21. RECONCILIATION OF MOVEMENTS IN GROUP SHAREHOLDERS' FUNDS

	2011 £m	2010 £m
Loss for the financial year	**(102.2)**	(66.9)
Dividend paid on equity shares (see note 10)	**(60.0)**	–
Cash flow hedges (net of deferred tax)	**1.9**	2.5
Actuarial gain/(loss) on defined benefit pension scheme (net of related tax)	**30.8**	(83.3)
Movement in shareholders' deficit	**(129.5)**	(147.7)
Opening shareholders' deficit	**(384.5)**	(236.8)
Closing shareholders' deficit	**(514.0)**	(384.5)

22. CASH FLOW FROM OPERATING ACTIVITIES

Reconciliation of operating profit to net cash inflow from operating activities:

	2011 £m	2010 £m
Continuing operations		
Operating profit	**113.0**	133.2
Depreciation charge	**105.0**	97.8
Goodwill amortisation	**9.5**	9.7
Amortisation of deferred income	**(2.8)**	(2.4)
Profit on disposal of fixed assets	**(0.8)**	(0.5)
(Increase)/decrease in debtors	**(6.5)**	8.8
Decrease in creditors	**(23.7)**	(11.0)
Movement in provisions	**(1.0)**	(5.4)
Total net cash inflow from operating activities	**192.7**	230.2

Notes to the financial statements (continued)
for the year ended 31 March 2011

23. ANALYSIS OF NET DEBT

	1 April 2010 £m	Cash flow £m	Non-cash changes £m	**31 March 2011 £m**
Bank overdraft	(6.5)	(0.8)	–	**(7.3)**
Debt due within one year:				
– Financial Instruments	(48.1)	–	4.2	**(43.9)**
– Floating rate loan	(324.8)	325.6	(0.8)	**–**
Debt due after more than one year:				
– Bonds	(2,778.5)	(175.0)	(38.0)	**(2,991.5)**
– Bank loans	–	(170.0)	1.7	**(168.3)**
– Shareholders' loans	(533.6)	–	–	**(533.6)**
Onerous financial instruments	(171.1)	19.8	(5.3)	**(156.6)**
Other financial instruments	86.7	(83.5)	8.2	**11.4**
Short term deposits	138.3	(92.5)	–	**45.8**
	(3,637.6)	**(176.4)**	**(30.0)**	**(3,844.0)**

Short term deposits comprise short term highly liquid investments with a maturity of three months or less.

Non-cash changes noted above represent fair value movements on financial instruments (see note 17) and interest incurred on index-linked bonds during the year which has not been paid and has been included within the carrying value of amounts borrowed.

24. OPERATING LEASE COMMITMENTS

The Group has lease agreements in respect of properties for which the payments extend over a number of years.

	2011 £m	2010 £m
Annual commitments under non-cancellable operating leases expiring:		
Within one year	**–**	0.1
Within two to five years	**–**	–
After five years	**0.5**	0.5
	0.5	0.6

The Company has no operating lease commitments in either year.

25. CAPITAL COMMITMENTS

Capital projects contracted for by the Group but not provided in the financial statements amounted to £20.4m at 31 March 2011 (2010: £39.5m). The Company has no capital commitments at 31 March 2011 (2010: £nil).

26. PENSION COMMITMENTS

A significant proportion of the Group's employees are members of the Scotia Gas Networks Pension Scheme ("the Scheme"). The Scheme provides final salary defined benefits for employees who joined the Lattice Group Scheme prior to 31 March 2002. A defined contribution section was added to the Lattice Group Scheme from 1 April 2002 for employees joining the Lattice Group Scheme from that date. Employees of the Group who were previously members of the Lattice Group Scheme transferred to the Scotia Gas Networks Pension Scheme on 1 December 2005.

a) Defined benefit scheme

The Scheme is operated by the Group and is funded with assets held in separate trustee administered funds. It is subject to independent valuations at least every three years, on the basis of which the qualified actuary determines the rate of employers' contribution, which, together with the specified contributions payable by the employees and proceeds from the scheme's assets, are expected to be sufficient to fund the benefits payable under the scheme.

The latest full actuarial valuation was carried out as at 31 March 2009. In accordance with FRS 17, a limited actuarial review has been carried out by Hymans Robertson at 31 March 2011 using the projected unit method.

The following financial assumptions have been used:

As at 31 March

	2011	2010	2009	2008
Discount rate	**5.5% p.a.**	5.5% p.a.	6.7% p.a.	6.9% p.a.
Inflation assumption	**3.5% p.a.**	3.7% p.a.	3.0% p.a.	3.5% p.a.
Rate of increase of salaries	**5.0% p.a.**	5.2% p.a.	4.5% p.a.	5.0% p.a.
Rate of increase of pensions payment	**3.5% p.a.**	3.7% p.a.	3.0% p.a.	3.5% p.a.

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 expectancy in years for a member once they reach age 65 is as follows:

As at 31 March

	2011		2010		2009	
	Male	**Female**	Male	Female	Male	Female
Member currently aged 65	**21**	**23**	21	23	23	26
Member currently aged 45	**24**	**27**	24	27	26	28

The fair value of the assets in the scheme, the present value of the liabilities in the scheme and the expected rate of return were:

As at 31 March

	2011		2010		2009		2008		2007	
	Long term rate of return expected	**Value £m**	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m
Equities	**7.8%**	**279.5**	8.0%	308.3	7.7%	194.7	8.0%	234.5	8.0%	235.7
Government bonds	**4.3%**	**99.2**	4.5%	50.7	4.2%	63.6	4.5%	71.5	4.5%	64.3
Corporate bonds	**5.5%**	**134.3**	5.5%	63.1	6.7%	30.2	6.9%	25.8	5.1%	31.3
Property	**5.3%**	**36.3**	5.5%	20.2	5.2%	12.4	5.5%	22.5	5.5%	15.3
Cash	**1.5%**	**9.9**	1.1%	26.6	2.2%	17.2	5.8%	14.6	5.9%	1.0
Total market value of assets		**559.2**		468.9		318.1		368.9		347.6
Actuarial value of liabilities		**(624.7)**		(618.4)		(368.8)		(341.7)		(414.6)
(Deficit)/surplus in scheme		**(65.5)**		(149.5)		(50.7)		27.2		(67.0)
Related deferred tax asset/(liability)		**17.2**		41.9		14.2		(7.6)		20.1
Net pension (liability)/ asset		**(48.3)**		(107.6)		(36.5)		19.6		(46.9)

The expected return on scheme assets represents the expected return of each major class of assets in which the scheme invests. Expected yield on fixed interest instruments are based on gross redemptions yields at the balance sheet date. Expected return on equity interests reflect real rates of return experienced in the relevant markets.

Notes to the financial statements (continued)
for the year ended 31 March 2011

26. PENSION COMMITMENTS (continued)

Movement in fair value of scheme assets

	2011 £m	2010 £m
At 1 April	**468.9**	318.1
Expected return on scheme assets	**34.4**	21.7
Contributions from scheme members	**1.7**	1.7
Contributions from the Company	**64.4**	34.5
Actuarial (losses)/gains	**(3.3)**	98.1
Benefits paid	**(6.9)**	(5.2)
As at 31 March	**559.2**	468.9

Movement in fair value of scheme liabilities

	2011 £m	2010 £m
At 1 April	**(618.4)**	(368.8)
Service cost	**(22.7)**	(14.2)
Interest cost	**(34.5)**	(25.1)
Contributions from scheme members	**(1.7)**	(1.7)
Actuarial gains/(losses)	**45.7**	(213.8)
Benefits paid	**6.9**	5.2
At 31 March	**(624.7)**	(618.4)

The Group's contribution rate during the year was 37.3% of pensionable earnings. Additionally, the Group made special pension contributions to repair the deficit amounting to £43.5m. The expected contributions to be made in the year to 31 March 2012 are 37.3% of pensionable salary.

The actual loss on scheme assets was £37.7m (2010: gain of £76.4m).

The cumulative amount of actuarial losses recognised in the statement of total recognised gains and losses since the adoption of FRS 17 is £68.3m (2010: £110.7m).

Analysis of the amounts recognised in the profit and loss account

	2011 £m	2010 £m
Amount charged to operating profit:		
Current service cost	**(22.7)**	(14.2)
Analysis of the amount credited to finance income:		
Expected return on pension scheme assets (see note 6)	**34.4**	21.7
Interest on pension scheme liabilities (see note 6)	**(34.5)**	(25.1)
Net finance charge	**(0.1)**	(3.4)
Net charge to the profit and loss account	**(22.8)**	(17.6)

Analysis of the amount recognised in the statement of total recognised gains and losses (STRGL)

	2011 £m	2010 £m
Actual return less expected return on pension scheme assets	**(3.3)**	98.1
Experience losses on scheme liabilities	**(15.6)**	(20.7)
Changes in financial assumptions underlying the present value of the scheme liabilities	**61.3**	(193.1)
Deferred tax	**(11.6)**	32.4
Actuarial gain/(loss) recognised in STRGL	**30.8**	(83.3)

History of experience gains and losses

	2011	2010	2009	2008	2007
Difference between the expected and actual return on scheme assets	**(£3.3m)**	£98.1m	(£82.8m)	(£36.8m)	(£3.4m)
– Percentage of scheme assets at year end	**(0.6%)**	20.9%	(26.0%)	(10.0%)	(1.0%)
Experience gains/(losses) on scheme liabilities	**£15.6m**	(£20.7m)	–	–	(£31.3m)
– Percentage of the present value of scheme liabilities at year end	**2.5%**	(3.3%)	–	–	(7.5%)
Changes in financial assumptions underlying scheme liabilities	**£30.1m**	(£193.1m)	£8.1m	£112.6m	£31.0m
– Percentage of the present value of scheme liabilities at year end	**9.8%**	(31.2%)	2.2%	32.2%	7.5%
Total actuarial gains/(losses) recognised in the statement of total recognised gains and losses	**£42.4m**	(£115.7m)	(£74.7m)	£75.8m	(£3.7m)
– Percentage of the present value of scheme liabilities at year end	**6.8%**	(18.7%)	(20.2%)	22.2%	(0.9%)

Movement in deficit during the year

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Deficit in scheme at start of year	**(149.5)**	(50.7)	–	(67.0)	(59.2)
Movement in year:					
– Current service costs	**(22.7)**	(14.2)	(13.5)	(18.4)	(19.7)
– Contributions	**64.4**	34.5	34.5	34.2	12.8
– Other finance (expense)/income	**(0.1)**	(3.4)	3.0	2.6	2.8
– Actuarial gain/(loss)	**42.4**	(115.7)	(74.7)	75.8	(3.7)
Restriction of recognised surplus	**–**	–	–	(27.2)	–
Deficit in scheme at end of year	**(65.5)**	(149.5)	(50.7)	–	(67.0)

b) Defined contribution schemes

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

	2011 £m	2010 £m
Amount charged in respect of defined contribution schemes	**2.0**	1.9

27. RELATED PARTIES

The Company is owned by a consortium consisting of Scottish and Southern Energy plc (50%), OTPPB Investments (UK) Limited (25%), which is owned by Ontario Teachers' Pension Plan Board and Borealis Infrastructure Europe (UK) Limited (25%) which is indirectly wholly owned by OMERS Administration Corporation.

It is the opinion of the Directors that the Group and Company have no single controlling party as the Company is controlled jointly by the consortium.

Notes to the financial statements (continued)
for the year ended 31 March 2011

27. RELATED PARTIES (continued)

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

	Group	
	2011 £m	2010 £m
Shareholders' loans:		
Scottish and Southern Energy plc	**266.8**	266.8
Borealis (Luxembourg) SCA (1)	**133.4**	133.4
OTPPB Investments (UK) Limited	**133.4**	133.4
	533.6	533.6
Interest owed to shareholders:		
Scottish and Southern Energy plc	**11.3**	11.3
Borealis (Luxembourg) SCA	**5.7**	5.7
OTPPB Investments (UK) Limited	**5.7**	5.7
	22.7	22.7
Other amounts owed to shareholders:		
Scottish and Southern Energy plc	**16.1**	13.6

(1) Borealis (Luxembourg) SCA is an affiliate of Borealis Infrastructure Europe (UK) Limited.

The aggregate interest expense charged to the profit and loss account in respect of shareholders' loans was £66.7m (2010: £67.5m). Interest accrues on the shareholders' loans at a fixed rate of 12.5% per annum and is payable semi-annually in arrears on 30 November and 31 May each year. The Company may, upon giving due notice, elect to pay some or all of the interest payable through the issuance of further loans to its shareholders.

Other than interest charges relating to shareholder loans, the following transactions took place during the year between the Group and the Scottish and Southern Energy plc group of companies (SSE).

	2011 £m	2010 £m
Sales of goods and services	**131.2**	145.0
Purchase of goods and services	**(62.4)**	(55.8)
Sale of tax losses	**5.6**	–

Sales of goods and services to SSE primarily represent gas transportation services. At 31 March 2011 an amount of £12.1m (2010: £12.8m) was owed by SSE in relation to these services and is included within trade debtors.

SSE provides services to the Group in the form of a management services agreement for corporate services. The Group also purchases certain items such as consumables stock, shrinkage gas and public liability insurance from SSE. Included within purchases of goods and services are direct costs in relation to tangible fixed asset and acquisitions projects incurred by SSE which have been recharged to the Group and capitalised. These costs amounted to £0.6m (2010: £1.1m).

During the year, the Group surrendered gross tax losses of £22.8m to SSE (2010: £nil) relating to the year ended 31 March 2009 for an aggregate cash consideration of £5.6m (2010: £nil).

Negotiations are ongoing for the proposed purchase by the Group from SSE of the anaerobic digester plant at Barkip, in Ayrshire Scotland.

Designed and produced by Tayburn

Scotia Gas Networks
St Lawrence House
Station Approach
Horley, Surrey
RH6 9HJ

Scotland Gas Networks
0845 070 1432

Southern Gas Networks
0845 070 1431

www.sgn.co.uk

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