Scottish Hydro Electric Power Distribution plc

Directors report and regulatory financial statements

Year ended 31 March 2018

Registered No.: SC213460

Scottish Hydro Electric Power Distribution plc

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Scottish Hydro Electric Power Distribution plc

Directors and Other Information

Directors	Gregor Alexander (Chairman) Steven Kennedy Stuart Hogarth David Gardner Colin Nicol Robert McDonald (Resigned 14/12/17) Dale Cargill Rachel McEwen Katherine Marshall (Appointed 14/12/17) David Rutherford (Non-Executive Director) Gary Steel (Non-Executive Director)
Registered office	Inveralmond House 200 Dunkeld Road Perth PH1 3AQ
Secretary	Mark McLaughlin
Auditor	KPMG LLP Chartered Accountants 319 St Vincent Street Glasgow G2 5AS
Registered number	SC213460

Scottish Hydro Electric Power Distribution plc

Strategic Report

The Strategic Report sets out the main trends and factors underlying the development and performance of Scottish Hydro Electric Power Distribution plc (the "Company") during the year ended 31 March 2018, as well as those matters which are likely to affect its future development and performance.

The business, its objectives and strategy

The Company is a wholly owned subsidiary of SSE plc (the "Group"). The Company's immediate parent is Scottish and Southern Energy Power Distribution Limited (SSEPD) which is branded as Scottish and Southern Electricity Networks (SSEN). Included within this group are sister companies, Scottish Hydro Electric Transmission plc (SHET) and Southern Electric Power Distribution plc (SEPD). The Company distributes electricity to around 870,000 customers in the North of Scotland. It currently has over 49,000 (*2017: 48,000*) kilometres of electricity mains on commission. The Company also provides electricity connections within the Company's licensed area and owns and operates a number of the out of area electricity networks in the rest of Scotland.

The Company is the subject of incentive-based regulation by the industry regulator, the Office of Gas and Electricity Markets (Ofgem), which sets the prices that can be charged for the use of the electricity network, the allowed capital and operating expenditure, within a framework known as the Price Control. In broad terms, Ofgem seeks to strike the right balance between attracting investment in electricity networks, encouraging companies to operate the networks as efficiently as possible and ensuring that prices for customers are no higher than they need to be. Ofgem also places specific incentives on companies to improve their efficiency and quality of service. The Company is currently within the RIIO-ED1 (Revenue = Incentives + Innovation + Outputs) Price Control period which runs for eight years from 1 April 2015 until 31 March 2023.

The Company's strategy and main objectives are to:

- comply fully with all electricity network safety standards and environmental requirements;
- ensure that the electricity network is managed as efficiently as possible, including maintaining tight controls over operational expenditure;
- provide good performance in areas such as reliability of supply, customer service and innovation and thus earn additional incentive-based revenue under the various Ofgem schemes;
- deliver efficient and innovative capital expenditure programmes, so that the number and duration of power cuts experienced by customers is kept to a minimum;
- grow the Regulated Asset Value ("RAV") of the business and so secure increased revenue;
- engage constructively with the regulator, Ofgem, to secure regulatory outcomes that meet the needs of customers and investors; and
- engage with the wider networks industry and other stakeholders to define and implement the process of distribution companies moving to a Distribution System Operator (DSO) role.

Business performance overview

The key performance indicators of the Company and the related performance during the year to 31 March 2018 were as follows (comparisons with the same period to 31 March 2017. Capital expenditure has been restated in line with note 1):

Financial / Operational	**2018**	2017	% change
Capital expenditure - £m	**110.7**	128.9	(14.1)
Operating profit - £m	**129.1**	120.7	7.9
Regulated asset value (RAV) - £m	**1,092.0**	1,043.6	4.6

Non Financial / Management	**2018**	2017	% change
Customer Minutes Lost - number per customer	**55**	60	(8.3)
Customer Interruptions - number per 100 customers	**57**	68	(16.2)
Electricity distributed (TWh)	**7.7**	7.7	-

The operating profit is broadly in line with the prior year, largely due to the small decrease in regulated revenue as a result of the various factors inputting to the Price Control revenue formula mechanism being more than offset by a decrease in operating expenditure, which included close control over operational costs and a reduction in rates charges.

Business performance overview *(continued)*

If in any year, regulated network companies' revenue is greater (over recovery) or lower (under recovery) than is allowed under the ED1 Price Control, the difference is carried forward and the subsequent prices the companies may charge are adjusted. Under the regulatory framework, distribution tariffs are set two years in advance which means the over/under recovery built into tariffs is a forecast and will differ from the actual outturn. Any difference is reflected in tariffs two years later meaning any difference in the 2017/18 forecast compared to actual will be fully unwound through revenue by 2022, making this is in essence a four year cycle. In 2017/18 there was an over recovery of approximately £7.1m (2016/17: £2.5m) which will be seen through revenue in future years.

During the year, the Company's Customer Minutes Lost decreased to 55 minutes per customer and Customer Interruptions decreased to 57 per 100 customers. The Company continues to outperform the pre-determined targets set by Ofgem, see the ''Keeping the lights on' for customers' section for more details.

Volume of electricity distributed

The total volume of electricity distributed by the company during 2017/18 was 7.7TWh, consistent with the previous year. Under the RIIO-ED1, the volume of electricity distributed does not affect the Company's overall allowed revenue (although it does have an impact on the timing of revenue collection).

Delivering for customers under the incentive based framework

The Company is now three years into the RIIO-ED1 Price Control and continues to deliver significant changes to its operations, processes and standards to ensure the needs of its customers remain at the forefront of decision making.

The Company's performance is assessed against the commitments made in its business plan and this influences the revenue which is earned. The key areas addressed are: network availability and reliability; social obligations; safety; environmental impact; connections; and customer satisfaction.

The outcomes of the incentive based framework within which the Company operates are increasingly dependent on customer opinion and feedback, providing opportunities for additional earnings through a range of incentive schemes. The additional incentive based performance is measured against: The Interruption Incentive Scheme; Ofgem Customer Satisfaction Measures; Complaints Performance; Stakeholder Engagement and Customer Vulnerability; and Incentive in Connections Engagement. A requirement for continual improvement is built into the incentives framework, this means if performance measures do not demonstrate improvement year on year, incentive income falls.

By making a concerted effort to focus on its people and its processes, the Company has made significant changes to ensure it is meeting its customers' needs and delivering against the measures as set by the RIIO-ED1 price control. This has ensured it is able to deliver outputs aligned to the expectations of its customers, stakeholders and the regulator while delivering a fair financial return to investors.

'Keeping the lights on' for customers

A fundamental responsibility of the Company is to 'keep the lights on' for its customers. Through the RIIO-ED1 price control, the Company is incentivised on its performance against the loss of electricity supply through the recording of Customer Interruptions (CI) and Customers Minutes Lost (CML), which include both planned and unplanned supply interruptions. This is part of the Interruption Incentive Scheme (IIS).

The Company has experienced an increase in IIS incentive income, earning £2.1m (2016/17: £0.8m) due to improvements in CI and CML during the year. During 2017/18, CI decreased to 57 (2016/17: 68) and the average CML decreased to 55 (2016/17: 60).

The Company's commitment to providing a safe and secure electricity supply and to minimise unplanned interruptions requires a continuous programme of investment in the network. This includes the refurbishment and reinforcements of assets; upgrades to automation which reduces the number of customers affected and the duration of faults; minimise the impact of tree related damage; as well as investments in new innovative technologies.

Strategic Report *(continued)*

Providing leading customer service and engaging with stakeholders

Since the beginning of the RIIO-ED1 price control, the Company has implemented significant changes to its customer services operations to improve the journey for its customers and respond to the incentive based framework.

The Company's continued focus on its customers and doing the right thing has resulted in a total incentive reward of £1.7m for 2017/18 against the Customer Satisfaction (or Broad) Measure Incentive which is slightly higher than in the previous year (£1.6m).

To benchmark its performance against leading customer service providers, SSEN has become a member of the Institute of Customer Service. The Company continues to look across a range of sectors to help it achieve its ambition to be recognised for providing leading customer service.

The Company remains fully committed to supporting its customers who require extra help and ensuring suitable support is provided to its Priority Services Register (PSR) Customers during network outages. Supporting vulnerable customers is also a key component of the Stakeholder Engagement and Consumer Vulnerability (SECV) Incentive and contributes to 25% of the total award available. In respect of performance in 2016/17, the Company was awarded £0.27m under the SECV incentive against a total available reward of £1.1m. The outcome of the SECV incentive for 2017/18 will not be known until the second half of 2018.

A key challenge continues to be identifying customers who are eligible for support through its PSR. The Company continues to look at innovative ways of reaching these customers, from its vulnerability mapping tool, to working with external partners and trusted intermediaries building on existing partnerships and forging new relationships with a broad and diverse range of organisations, such as NHS Highland, helping broaden the reach of the Company's support.

Continuing improvements in connections

Over recent years, the Company has made significant changes and improvements to its connections process, informed by the needs and expectations of customers, which was reflected by an award of £0.9m under the Average Time to Connect Incentive for 2017/18 against a total reward available of £0.9m.

This commitment to place its connections customers at the heart of its processes was also reflected by the Company avoiding a penalty for the second consecutive year under the penalty-only Incentive in Connections Engagement (ICE) for 2016/17. The outcome of ICE for 2017/18 will not be known until the second half of 2018.

Targeting frontier incentive performance

Performance in relation to interruptions, customer service and connections, plus stakeholder engagement, are the subject of an incentives framework which rewards companies for good performance but also penalises them where performance does not meet required standards. In summary, this provides an opportunity for network operators to share in the rewards from delivering improvements for its customers. Improved performance against these metrics remains a key objective for the Company.

Looking collectively at RIIO-ED1 incentive performance during 2017/18, the Company earned £5.0m from a maximum available award of £13.8m. It also avoided penalty-only awards totalling £3.1m.

The Company is targeting operational improvements across its business to drive performance, including the increased use of automation, the monitoring of multiple interruptions and 'at risk' circuits, and a consistent approach for design and quotation in connections. A new Customer Relationship Management system will be introduced in 2019, which will provide a platform for effective management of customer-related issues.

The Company is confident these incremental improvements in reliability, customer service and connections, plus stakeholder engagement, will move it closer to maximising its incentive income as it progresses through the RIIO-ED1 price control.

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Strategic Report *(continued)*

Delivering a major programme of capital investment

The Company continues to undertake a major capital investment delivery programme which will deliver significant improvements for its customers and provide the infrastructure required to support economic development, as well as contributing to sustained and fair returns and increased RAV.

In 2017/18 the Company invested a total of £110.1m regulatory capital expenditure in its network, bringing the total invested in the first three years of the ED1 Price Control to £318.5m.

The Company is taking forward a major rolling programme of investment to replace the existing subsea cables which have successfully and safely served the Scottish islands for many decades. With a forecast investment of more than £100m across ED1, subject to regulatory approval, the responsible and evidenced based approach the Company has adopted to inform its subsea cable replacement programme will deliver RAV growth, whilst minimising the cost impact to its customers.

The Company's disciplined and efficient approach, underpinning the delivery of its capital and strategic investment programme, will ensure it continues to deliver value for energy consumers and provide a fair return on investment for shareholders.

Leading on networks innovation

Innovation continues to play a key role in the development and improvement of the service provided to the Company's customers and, at the same time, help inform the wider industry as it prepares for fundamental changes to the electricity system.

The Company has a clear track record in progressing innovation through Ofgem funded structures, securing over £27m in regulatory funding for innovation projects since 2010. This record was strengthened in July 2017, when SSEN was awarded an additional £2m as a discretionary award from Ofgem for its Tier 1 innovation projects, the highest amount awarded to any Distribution Network Operator (DNO) group, with £1m of this being applicable specifically to the Company.

The Company has also been successful in progressing new initiatives outside of funding mechanisms, where benefits to the efficiency of operations or delivery for customers are proven. This includes investment in aerial scanning of its overhead network using LiDAR technology, which is now 90% complete. This initiative, which will give measurements accurate to 2cm, will bring significant benefits in ensuring safety and asset compliance, efficient vegetation management and, ultimately, improved fault performance. Along with its sister company SEPD, the Company is within the first distribution network operator group to bring this technology into business- as-usual operation.

In 2017/18, many of the Company's innovation projects, such as a trial of Constraint Managed Zones, were designed to inform the wider industry on the move to a new, smart, flexible system and the transition of DNOs to a new Distribution System Operator (DSO) role.

Supporting the transition to a smart, flexible electricity system

One of the biggest changes in the energy system is the flexibility revolution. Distributed generation, electric vehicles, demand-side response and energy storage are transforming the energy system and giving customers access to new products and services from a new range of providers.

DNOs will play a pivotal role in this revolution which will increase the investment needed across networks, creating new opportunities in managing this demand.

In November 2017, alongside SEPD, the Company published its DSO strategy, Supporting a Smarter Electricity System, setting out the five key principles it believes should underpin the transition to a smart, flexible electricity system. These are: working for all customers; ensuring cost efficiency; market neutrality; removing barriers to local solutions; and adopting an approach of learning by doing.

The Company continues to play a leading role in the influential Open Networks project, led by the Energy Networks Association, and will continue to engage with industry, policy-makers and the regulator in support of a phased approach to the DSO transition whereby impacts can be carefully reviewed and the best interests of customers maintained.

Preparing for the electrification of transport

A key aspect of the transition to a smart, flexible electricity system is the electrification and decarbonisation of transport. The Company continues to respond to the growth in electric vehicles (EV) which is forecast to accelerate in the coming years in response to ambitious targets set by both the UK and Scottish Governments to phase out petrol and diesel vehicles by 2040 and 2032 respectively.

To prepare for the likely growth in uptake of EV and Low Emissions Vehicles, the Company continues to support the industry in identifying the challenges and solution to ensure the transition is as smooth as possible. This includes a consultation published by SSEN in March on 'Managed Electric Vehicle Charging', which seeks views on proposed solutions to help avoid potential overloads on local electricity networks caused by sharp increases in the use of electric vehicles.

The consultation forms part of the Company's Smart EV project, undertaken alongside technology partners EA Technology and supported by GB distribution network operators. The project, funded by Ofgem's Network Innovation Allowance, sets out to review and research charging solutions that will allow the transition to EV to take place with minimum disruption to customers and avoiding unnecessary network reinforcement.

Looking ahead to RIIO-2

On 7 March 2018, Ofgem published a consultation on the regulatory framework for the next Price Control periods, RIIO-2, which run from April 2023 for electricity distribution.

In its consultation, Ofgem has set out that it expects the range of available returns for network businesses to be lower for the next round of Price Controls, while maintaining high levels of innovation and reliability. It has also set out its strongly "minded to" position to revert to five-year price control periods and confirmed a stronger voice for customers and stakeholders in the development of Price Control business plans through the establishment of independent user groups and panels.

Despite its focus on lower returns, Ofgem has confirmed it is still expected that high performing companies will continue to be rewarded through outperformance of the incentive based regulatory framework.

SSEN will continue to engage constructively with Ofgem and other stakeholders as the regulator further develops its proposals for RIIO-2, helping to ensure the evidence base is robust, the outcomes are clear and the views of customers, communities, stakeholders and investors are fully considered.

Electricity Distribution priorities

The Company's priorities in 2018/19 and beyond are to:

- operate safely and meet all compliance requirements;
- provide an excellent service to all customers who rely on their networks and related services;
- deliver required outputs while maintaining tight controls over expenditure;
- maintain good progress in the safe delivery of new assets;
- progress innovations that will improve network reliability, efficiency and customer service and inform industry-wide improvements;
- develop and maintain effective stakeholder relationships and conduct constructive engagement with regulators and legislators, advocating clarity and stability in the regulatory framework; and
- progress the transition towards operating in a DSO environment.

Values and responsibilities

The Group and the Company believe that the behaviours and culture of an organisation should be guided by its values, and that an organisation's values should be at its core. The Group has six core values which seek to bind the behaviour and attitude of its employees and those it works with. They are:

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Strategic Report *(continued)*

Values and responsibilities (*continued*)

- Safety: If it's not safe, we don't do it;
- Service: We are a company customers can rely on;
- Efficiency: We focus on what matters;
- Sustainability: We do things responsibly to add long-term value;
- Excellence: We continually improve the way we do things;
- Teamwork: We work together, respect each other and make a difference.

Understanding and managing our principal risks

To help ensure it is able to provide the energy people need and deliver value over the long term, the Group has continued to develop its Risk Management Framework, including its Principal Risks and its Risk Appetite Statement. For further detail on how the Group manages risk see the Risk Management Frameworks section in the SSE plc Annual Report (www.sse.com).

The Group Risk Management Policy requires the Managing Director of each Division to implement a Divisional Risk Approach to support their business in identifying, understanding and managing its key risks. Each division carries out an annual Assurance Evaluation with key Group policies, with the output and any areas of required improvement reported to the Group's Chief Executive.

The risks faced by the Company have been considered by the Company Board during the financial year. These have been reviewed in line with the Group approach to risk. Risk workshops have been attended by the Networks Management Committee and Company's Board members during the year in order to aid identification of the risks specific to the business. As a result of this process, the main risks were identified which have the potential to threaten the business model, future performance, solvency or liquidity of the Company. An overview of these risks and the mitigating actions are as follows:

- **Safety, Health and Environment** – The Company's operations are in many cases undertaken in hazardous environments and involve working with high voltage electricity in a wide variety of locations. Some of our operations require the storage of a significant volume of fuel, oil and other chemicals, and any uncontrolled release of these could result in injury to our staff, contractors or members of the public and damage to the environment. Safety is the number one value and priority for the Group and Company. There is a Safety Management System in place to support people at work and ensure their safety and significant focus on both technical and behavioural safety training. In addition, crisis management and business continuity plans are in place to manage and recover from any significant events.
- **Regulation, Legislation and Compliance** – Regulation, legislation and compliance affecting the Company is complex and fast-moving. Changes, either explicit or indirect, can lead to additional obligations and can have a significant effect on the profitability of our asset base. This risk is mitigated jointly by Company management and staff along with the Group's dedicated Corporate Affairs, Regulation, Legal and Compliance departments which provide advice to the Company on the interpretation of political and regulatory change. In addition there is proactive engagement with regulators, politicians, officials and other stakeholders on these issues.
- **Network Resilience and Integrity** – The Company has an obligation to maintain and enhance its network and ensure its resilience. A robust asset management and quality assurance process is in place to ensure that equipment is of the correct standard and specification to provide a safe, efficient and reliable network now and in the future. The impact of adverse weather on our network infrastructure is an annual event and due to perceived impacts of global climate change, it is anticipated that the volume and impact of these events will increase. The Company has many years experience in dealing with these events and there is significant effort directed to forecasting such events and ensuring that there are plans in place to deal with them. This involves early deployment of staff to potentially affected areas and ensuring sufficient staff and other resources are available to effectively deal with any disruption.
- **Networks Change Transformation** – The energy industry is undergoing constant technological and regulatory change. It is important that the Company is able to stay at the forefront of the industry by identifying emerging trends and developing strategies to exploit competitive opportunities. Through the ED1 settlement, the Company has proposed significant reductions in the overall cost and improvements in the standard of service that customers can expect to receive. To deliver this successfully, we will need to transform our business and people, delivering major cost efficiencies, new IT systems and improvements in customer service. The projects to deliver these business transformations are large and complex. These projects will draw on resources from across the business and poor management of these resources, poor integration or inadequate scoping of project requirements and benefits could impact on business as usual activities, increase project costs

Understanding and managing our principal risks (*continued*)

and adversely affect service standards. The Company has installed appropriate governance processes and procedures at Board and Leadership team levels to monitor the transformation process.

- **Supply Chain and Contractor Performance** – The Company continues to deliver its capital investment programme with a number of ongoing network construction and IT projects. It is critical that these projects are delivered on time, on budget and to high standard given the long term nature of the business. The Company will typically manage the development process and organise the delivery of the project by third party contractors, taking a pro-active oversight role during the procurement and construction phase. Whilst this model ensures that the correct skills are leveraged, there is a risk of supplier failures, faulty components, and quality defects. The Group-wide Large Capital Projects Governance framework helps to mitigate this risk by ensuring a consistent approach to project development and delivery as well as proactive engagement with the supply chain.
- **Price Control Governance and Management** – The Company needs to meet its RIIO-ED1 published business plan obligations or risk financial penalties and the resultant reputational risk (these deliverables include meeting the (Total Expenditure) Totex project milestones and output measures, ensuring data quality and accuracy, achieving stakeholder satisfaction and environmental outputs and facilitating a new energy solution for Shetland). The structure of the business, management oversight and the governance frameworks in place are designed in order to ensure that this risk is monitored and mitigated.
- **Cyber Security** - With the increased incidence of cyber attacks over recent years there is a risk to the Company's key systems and, as a result, the network could be compromised or rendered unavailable. To mitigate this risk, the Group and Company are investing in a long term security programme including liaising with relevant external stakeholders and ensuring staff awareness of IT security issues and their importance.
- **Alternative Technologies** – Technological developments may identify alternative or more efficient means of distributing electricity. It is important that the business is aware of and keeps pace with the application of these technological improvements in order to improve efficiency and value to the end consumer. The Company has a dedicated team who look at incremental technologies aimed at increasing the reliability and efficiency of network assets as well as converting these new technologies into business as usual.

Employees

The Group and Company wants to be a great place to work; characterised by the engaged, motivated and committed people who already work throughout the company and an ability to attract a talented and diverse range of new people to meet changing business needs.

That is why the Group and the Company has clear priorities for how they:

- engage with the people who work for the Group and recognise the different needs they have;
- create sustainable employment opportunities that attract a talented and diverse range of new people into all levels of the business;
- invest for the future to ensure each individual can perform to the best of their ability; and
- ensure they are constantly seeking to do the right things, particularly in how people are treated.

Of all employees in the Company, 82% are men and 18% are women. It is Company policy, where possible, to provide employment opportunities for disabled people. Staff who become disabled are supported in continuing employment through identification of suitable jobs and the provision of necessary re-training.

Rewarding employee contribution

The Group and Company have a well-established approach to performance management with a structured framework which assesses employee performance against individual agreed objectives as well as alignment to the core values of Safety, Service, Efficiency, Sustainability, Excellence and Teamwork. Employees at all levels in the organisation are measured against the same framework, and performance review sessions are designed to allow employees to provide feedback and think about their opportunities for personal and professional development.

Rewarding employee contribution (*continued*)

The opportunity to grow and develop a career has the greatest impact on employee commitment but it is also understood that employee benefits make an important contribution to both employee engagement and the attractiveness of the Group as a place to choose to work.

- **Employee benefits**: Following on from the sector-leading parental pay and support benefits introduced on 1 April 2017, the Group introduced a series of further measures to benefit all employees and consolidated its existing benefits. New benefits include 'Nudge for SSE', an external financial education tool to help employees better understand and manage their personal finances, 'SSE Advantage' which offers savings and cashback deals, and 'Back to Health', a pilot programme with Nuffield Health to provide additional support and specialist care for employees with anxiety, depression, stress or musculoskeletal problems.
- **Sharing success**: The Group actively encourages it employees to own SSE shares, offering both an employee Share Incentive Plan (SIP) and a Sharesave scheme.
- **The Group pension schemes**: In 2017/18, the Group moved its employee pension scheme from its GPPP+ to a new Pension+ offering which provides improved value for employees and reduced management charges. 94% of the Group's employees chose to plan and save for their financial future with the Group in 2017/18.

Employee participation

The Group's long-established teamwork value has been an enduring value that guides employees in their day-to-day working lives.

Engagement is a good indicator of how connected employees are to an organisation and how committed they are to helping it to achieve its goals. SSE measures employee engagement through its full Great Place to Work survey every two years with a shorter 'pulse' survey on every alternate second year. The last full Great Place to Work survey was conducted with ORC International in July 2017. To promote transparency internally and externally around the results of the survey, in 2017/18 the Group published a short report with the results of the July 2017 survey and the company's action plan in response to its findings.

Social and community issues

The Company considers its relationship with the community it serves as a core part of its operations. Engagement with local users and the wider stakeholder community is a fundamental principle underlying the RIIO-ED1 price control, and the Company has a detailed stakeholder engagement plan in place to ensure that it is sufficiently informed by its customers and the community which it serves.

At a time in which the energy networks must be more responsive to stakeholder and customer needs, in March 2016, SSEN established an independent Stakeholder Advisory Panel. With membership from charities and external industry bodies, it works alongside the Board to help scrutinise key areas of business performance, the commitments made under the RIIO-ED1 price control and future plans. The Panel consists of a Chair and six members, recruited to reflect a broad range of external interests, skills, knowledge and experiences. Through its work, the panel brings stakeholder insight and challenge to SSEN's decision-making and long-term direction at the highest level, helping to drive improvement in key processes and outcomes for customers.

Internal control

The Group's Board performs a review of the effectiveness of the system of internal control annually across the Group.

The Directors acknowledge that they have responsibility for the Company's systems of internal control and risk management and for monitoring their effectiveness. The purpose of these systems is to manage, rather than eliminate, the risk of failure to achieve business objectives, and provide reasonable assurance as to the quality of management information and to maintain proper control over the income, expenditure, assets and liabilities of the Company.

No system of control can, however, provide absolute assurance against material misstatement or loss. Accordingly, the Directors have regard to what controls, in their judgement, are appropriate to the Company's business, to the materiality of the risks

Internal control (*continued*)

inherent in the business, and to the relative costs and benefits of implementing specific controls. This process is regularly reviewed by the Board and has been in place for the whole year.

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 are established procedures in place for regular budgeting and reporting of financial information. The Company's performance is reviewed by the Board as well as the Group Board. Reports include variance analysis and projected forecasts of the year compared to approved budgets and non-financial performance indicators.

There are Group policies in place covering a wide range of issues and risks such as financial authorisations, IT procedures, health, safety and environmental risks, crisis management, and a policy on ethical principles. The business risks associated with the Company's operations are regularly assessed by the Directors.

The effectiveness of the systems of internal control is monitored by the Group internal audit department. Their reports, which include where appropriate relevant action plans, are distributed to senior managers and Directors.

Environment

The Group's current 2020 carbon intensity target is supported by additional targets to address other carbon emissions across the Group, for example the reduction of carbon emissions relating to losses on the electricity distribution networks by 3% between 2015 and 2023. SSE is working towards setting a comprehensive science based target and will outline further targets that relate to these other emissions before the end of the financial year 2020.

The Group's scope 2 Carbon emissions fell by nearly 20% compared to 2016/17 and accounted for less than 4% of total carbon emissions in 2017/18. This reduction is mainly a result of lower electricity losses on the electricity networks and changes in carbon emission factors due to decarbonisation of the UK grid.

While the Company plays its part to mitigate climate change, it must also adapt its business to the impacts of rising global temperatures. Extreme weather events are a material climate adaptation risk that impacts the resilience of the Company's distribution network. As a result the Company has invested in maintenance and emergency response solutions. This includes new technology that identifies faults on lines; tree cutting along networks; resilience funds for local communities to support climate adaptation initiatives; and emergency response procedures to ensure the lights are kept on.

More information on the Group's approach to managing environmental impact is contained in the 2017/18 Annual Report, on page 72 at www.sse.com.

Key contractual arrangements

The Directors consider the Service Level Agreement in place between the Company and SSE Services plc for the provision of corporate services to be essential for the continuance of the Company's operations in the short-to-medium term. Due to the fact that it is provided by a fellow subsidiary of SSE plc, the risk of this contract being terminated is low.

There are a number of contracts with both internal and external parties for the provision of services to maintain and develop the Company's distribution network. It is not believed that any of these contracts are of sufficient size or concentration to result in a dependence on any one external supplier.

Resources available

As part of the Group, the Company has significant resources which it can draw upon to meet its service commitments. The Company benefits from Group-wide treasury management functions in order to provide adequate financing, with undrawn facilities totalling £1.5bn available to the Group at 31 March 2018 which could be made available to the Company if required.

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Strategic Report *(continued)*

Resources Available (*continued*)

During the year the Group extended its existing £1.5bn revolving credit and bilateral facilities by invoking the second of the two one year extension options with the facilities now maturing in July 2022 (£1.3bn) and November 2022 (£0.2bn). As at 31 March 2018, they were undrawn.

The Company has 1,382 employees which it calls on to maintain its distribution network and carry out investment in future developments. The Company also draws upon Group shared services covering central functions such as finance, HR, regulation, health and safety, company secretarial and insurance services. All such services are provided under an appropriate Service Level Agreement. In addition to these employees, the services of key contractors are called upon in a number of large capital projects to ensure that these projects are delivered on time and on budget.

Capital structure

The Company regards its capital as comprising its equity, cash and borrowings. Its objective in managing capital is to maintain a strong balance sheet and credit rating so as to maintain investor, creditor and market confidence and to sustain future development of the business. The capital structure is kept under review and the Directors believe that Group and Company both continue to maintain one of the strongest balance sheets in the global utility sector. The directors consider that this gives the Company significant competitive advantage in terms of cost of funding and supporting new developments.

Treasury policy, objectives and financial risk management

The Group's treasury policy is designed to be prudent and flexible. In line with that, cash from operations is first used to finance regulatory and maintenance capital expenditure and then dividend payments, with capital and investment expenditure for growth generally financed by a combination of: cash from operations; bank borrowings and bond issuance.

Exposure to interest rate risk arises in the normal course of the Company's business. Derivative financial instruments are entered into to hedge exposure to risk. The objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the year are explained in note 18.

The Company's financial risk is managed as part of the wider Group risk management policy. For more information regarding financial risk management, please see note A6 on page 217 of the Group's 2018 Annual Report at www.sse.com.

Liquidity

The Group's Treasury function acts on behalf of the Company and is responsible for managing the banking and liquidity requirements of the Group, risk management relating to interest rate and foreign exchange exposures and managing the credit risk relating to the banking counterparties with which it transacts. Short term liquidity is reviewed daily by Treasury, while the longer term liquidity position is reviewed on a regular basis by the Board. The department's operations are governed by policies determined by the Board and any breaches of these policies are reported to the Tax and Treasury Committee and Audit Committee.

Borrowings and facilities

The Company has loans of £437.7m (2017 – £432.7m) of which £300.0m (2017 – £300.0m) is due to other Group companies and £137.7m (2017 – £132.7m) is in the form of an index-linked bond. Of the total, interest is paid at fixed rates on £300.0m (2017 - £300.0m) and inflation-linked rates on £137.7m (2017 – £132.7m).

As at 31 March 2018, the weighted average interest rate payable was 4.67% (2017 – 4.68%) and the weighted average remaining term was 14.88 years (2017 – 15.61 years).

Taxation

The headline effective tax rate, which includes the impact of substantively enacted changes in the UK corporation tax rate, is 16.6% compared with 15.5% in the previous year.

Strategic Report *(continued)*

Dividend

Following a review of distributable reserves, the Directors declared, approved and paid a dividend of £20.0m (2017 – £50.0m) in the year.

Pensions

13% (2017 - 21%) of employees of the Company are members of the Scottish Hydro Electric Pension Scheme, which, at 31 March 2018 on an IAS 19 basis adjusted for IFRIC 14 had a surplus, net of deferred tax, of £371.9m included in the Group financial statements (2017 – surplus £341.5m).

On behalf of the board

Gregor Alexander
Director
18 July 2018

Scottish Hydro Electric Power Distribution plc

Corporate Governance Statement

As a subsidiary company of SSE plc ("The Group"), Scottish Hydro Electric Power Distribution plc ("The Company") operates within the Group's corporate governance framework. The Company does not have listed shares and therefore is not subject to the UK Corporate Governance Code and has not voluntarily applied the UK Corporate Governance Code. The information below, therefore, is in relation to the Group only and is included solely for information.

The Group's corporate governance policies are described in the Group's Annual Report and Accounts 2018 under Governance on pages 86 to 139 available at www.sse.com.

The Board of the Group considers that it complied in full with the UK Corporate Governance Code 2016 during 2017/18.

SSE plc Group ("the Group")

The Group has a responsibility to meet its objectives and operate sustainably for the benefit of all of its stakeholders, which includes upholding the commitments it has made to its shareholders and customers through its financial objective and core purpose. It is the role of the Board to ensure that these are achieved, and this is supported primarily through setting the Group's longer term strategy, providing the leadership and support necessary to ensure that it can be delivered responsibly within accepted levels of risk. Implementation and delivery of this strategy is managed through the careful delegation of authority in line with the Corporate Governance Framework, with oversight being retained through regular reporting, which includes an ongoing dialogue between the Board, the Executive Committee, their respective sub-Committees and other key individuals within the business.

The Group's core purpose is to provide the energy people need in a reliable and sustainable way while abiding by its core values: safety; service; efficiency; sustainability; excellence; and teamwork.

Each year the Group describes how it has applied the Main Principles of the UK Corporate Governance Code and in line with its 'comply or explain' model details any departures from its specific provisions. A departure is only ever made when it is deemed appropriate to do so, and good governance can be achieved by other means.

For 2017/18 the Board is reporting against the 2016 version of the Code and confirm compliance with its provisions in full.

There are four principal Board committees; an Audit Committee, a Remuneration Committee, a Safety, Health and Environment Advisory Committee and a Nomination Committee. The details of the appointees and work undertaken by these committees are included in the published annual report of the Group, which is available at www.sse.com.

There were two new appointments to the Board during the reporting year; one Executive Director and one independent non-Executive Director. The Board now comprises the Chairman, three Executive Directors, a Senior Independent Director and six independent non-Executive Directors. This gives the Board a good balance of independence and experience, ensuring that no one individual or group of individuals has undue influence over the Board's decision making.

The Audit Committee and the Health, Safety and Environmental Committee receive reports in respect of the Company's business performance and the relevant findings of these committees will be advised to the Company Board where appropriate.

Scottish Hydro Electric Power Distribution plc ("The Company")

The following comments on the arrangements for the Company.

Board of Directors

During the year the Board consisted of eight Executive Directors, one of whom is an Executive Director of the Group and one of whom is a member of the Group's Executive Committee. None of the Directors are Directors of Group Companies involved in Retail or Wholesale activities. The Group Executive Director is the Chairman of the Board. Company Board meetings were held on eight occasions during the course of the year. The Company does not have a Nomination, Remuneration or Audit Committee. These functions are dealt with in conjunction with the relevant committee of the Group Board. There were two independent Non-Executive Directors on the Board during the course of the financial year as required under the terms of Standard Condition 43A of the Company's regulatory licence.

The Board operates under approved terms of reference. The Board sets the strategic aims of the Company, supervises management, monitors and reports on performance, approves investment and is responsible for all statutory and regulatory approvals.

Attendance at meetings of the Board during 2017/18, expressed as a number of meetings attended out of number eligible to attend is set out below:

Director	Attendance
Gregor Alexander (Chairman)	8 of 8
Steven Kennedy	7 of 8
Stuart Hogarth	6 of 8
David Gardner	7 of 8
Colin Nicol	8 of 8
Robert McDonald (Resigned 14/12/17)	5 of 6
Dale Cargill	5 of 8
Rachel McEwen	7 of 8
Katherine Marshall (Appointed 14/12/17)	2 of 2
David Rutherford (Non-Executive Director)	8 of 8
Gary Steel (Non-Executive Director)	8 of 8

Board evaluation

A formal evaluation was carried out in 2016 and the results were used to develop actions and agree areas for improvement for the effective functioning and operations of the Board. This process was designed to confirm the areas where the Board was performing well and identify areas where improvements could be made. These improvements were implemented throughout the course of the current reporting year. An updated evaluation process is now underway and will be completed by September 2018.

Director induction, training and development

On joining the Board, all non-Executive Directors receive an induction tailored to their individual requirements. The comprehensive programme is facilitated by the Chairman and Company Secretary and involves briefings and meetings with key individuals from each business area and supporting Group functions. During the induction programme each Director is invited to identify areas in which they would like additional meetings or further information.

Throughout the reporting year the Directors develop and refresh their knowledge through various training sessions and a number of internally and externally facilitated engagements, with individual development needs being reviewed as part of the annual Board evaluation process. Directors are encouraged to request additional information and support at any time as required, with the necessary resources being made available to them.

Corporate Governance Statement *(continued)*

Going Concern

The Directors consider that the Company has adequate resources to continue in operational existence for the foreseeable future. In making their assessment, the Directors have considered future cash flows and the level of headroom on long-term loans and bonds. The regulatory financial statements are therefore prepared on a going concern basis.

Viability Statement

The Board has voluntarily carried out an assessment of the longer term viability of the Company consistent with the assessment and governance approach undertaken at Group level by SSE plc.

In doing so, the Board has assessed the prospects of the Company over the next 3 financial years to 31 March 2021. The Directors have determined that as this time horizon aligns with the Company's strategy planning period and committed networks resilience projects, a reasonable degree of confidence over the forecasting assumptions modelled can be established.

This statement is included solely for information.

In making this statement the Directors have considered the resilience of the Company taking into account its current position, the Principal Risks it faces and the control measures in place to mitigate each of them. In particular, the Directors recognise the significance of the Company's regulated revenue stream, strong balance sheet and access to available resources including the SSE Group's committed lending facilities of £1.5bn.

To support this statement, stress testing of scenarios relating to each of the Principal Risks facing the Company has been undertaken. Examples include failure of critical network technology (for Networks Resilience and Integrity) and failure to implement key system upgrades (for Networks Change Transformation).

Upon the basis of the analysis undertaken, and on the assumption that the fundamental regulatory and statutory framework in which the Company operates does not substantively change, the Directors have a reasonable expectation that the Company will be able to continue to meet its liabilities as they fall due in the period to 31st March 2021.

Scottish Hydro Electric Power Distribution plc

Directors' Report

The Directors present their report together with the audited regulatory financial statements for the year ended 31 March 2018.

Reporting requirements on the Company's principal activities and future developments, its principal risks and uncertainties and its key performance can be found in the Strategic Report.

1 Principal activities

The Company is responsible for managing an electricity distribution network, serving around 870,000 customers in the North of Scotland. Distribution of electricity and the level of capital investment within the network area is a monopoly activity and is closely regulated by Ofgem within a framework known as the Price Control. The Company also carries out the business of provision of new electrical connections services within its licensed area and the construction and management of out-of-area electricity networks in Scotland. A full review of the year is contained within the Strategic Report section of these regulatory financial statements.

2 Results and Dividends

The profit for the financial year amounted to £75.0m (2017 - £72.6m). A final dividend of £20.0m (2017 - £50.0m) was declared, approved and paid by the Board during the year.

3 Directors

The Directors and Secretary who served during the year are as listed on page 1. In accordance with the Articles of Association of the Company the Directors are not required to retire by rotation.

4 Corporate governance

The Corporate Governance statement for the Company is outlined on page 13.

5 Auditor

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each Director has taken all the steps that ought to have been taken as a Director to be aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

In accordance with Section 489 of the Companies Act 2006, a resolution for the re-appointment of KPMG LLP as auditors of the Company and Group is to be proposed at the forthcoming Annual General Meeting of the Group.

On behalf of the Board:

Mark McLaughlin
Company Secretary
18 July 2018

Scottish Hydro Electric Power Distribution plc

Statement of Directors' responsibilities in respect of the Strategic Report, the Directors' Report and the regulatory financial statements

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

Standard Licence Condition 44 requires the Directors to prepare regulatory financial statements for each financial year. Under that licence condition they have elected to prepare the regulatory financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice) including FRS 101 *Reduced Disclosure Framework*. The directors confirm that these regulatory accounts comply with Standard Licence Condition 44 in all aspects except with respect to the nature of the audit opinion. Ofgem have consented to this having regard to the guidance contained in the Institute of Chartered Accountants in England and Wales (ICAEW) Technical Release TECH02/16AAF.

Under Standard Licence Condition 44 the Directors must not approve the regulatory financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of its profit or loss of the Company for that period. In preparing the regulatory financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and 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 regulatory financial statements;
- assess the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its regulatory financial statements comply with the Companies Act 2006 and Standard Condition 44 as applicable. They are responsible for such internal control as they determine is necessary to enable the preparation of regulatory financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect 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 UK governing the preparation and dissemination of regulatory financial statements may differ from legislation in other jurisdictions.

On behalf of the Board:

Gregor Alexander
Director
18 July 2018

Independent auditor's report to Scottish Hydro Electric Power Distribution plc and to the Gas and Electricity Markets Authority ("GEMA" or the "Regulator")

Opinion

We have audited the regulatory accounts of Scottish Hydro Electric Power Distribution Plc ("the Company") for the year ended 31 March 2018 which comprise the Profit and Loss account, Balance Sheet, Statement of Other Comprehensive Income, Statement of Changes in Equity, Cash Flow Statement and related notes, including the accounting policies in note 1.

In our opinion the regulatory accounts of the Company for the year ended 31 March 2018 have been properly prepared, in all material respects, in accordance with Standard Condition 44 of the Company's Regulatory Licence and the special purpose basis of preparation and accounting policies set out in note 1.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800, and the terms of our engagement letter dated 18 July 2018 and having regard to the guidance contained in ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts' issued by the Institute of Chartered Accountants in England & Wales. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

Emphasis of matter – special purpose basis of preparation

We draw attention to Note 1 to the regulatory accounts, which describes their basis of preparation. As explained in that note, the regulatory accounts are prepared to assist the Company in complying with the Company's Regulatory Licence Standard Condition 44. The nature, form and content of regulatory accounts are determined by the Regulator. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purposes. Accordingly, we make no such assessment.

The regulatory accounts are separate from the statutory financial statements of the Company. There are differences between International Financial Reporting Standards as adopted by the EU and the basis of preparation of the regulatory accounts because Standard Condition 44 of the Regulatory Licence specifies alternative treatment or disclosure in certain respects. Where Standard Condition 44 of the Regulatory Licence does not specifically address an accounting issue, it requires International Financial Reporting Standards as adopted by the EU to be followed. Consequently the regulatory accounts may not necessarily represent a true and fair view of the financial performance or financial position of the Company as shown in financial statements prepared in accordance with the Companies Act 2006. As a result, the regulatory accounts may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

Going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the regulatory accounts. We have nothing to report in these respects.

Other information

The directors are responsible for the other information, which comprises the Corporate Governance Statement. Our opinion on the regulatory accounts does not cover the other information and, accordingly, we do not express an audit opinion or any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our regulatory accounts audit work, the information therein is materially misstated or inconsistent with the regulatory accounts or our audit knowledge. Based solely on that work, we have not identified material misstatements in the other information.

We have nothing to report in these respects.

Directors' responsibilities

As explained more fully in their statement set out on page 17, the directors are responsible for: the preparation of the regulatory accounts in accordance with the Standard Condition 44 of the Regulatory Licence and the special purpose basis of preparation and accounting policies as set out in note 1 to the regulatory accounts; such internal control as they determine is necessary to enable the preparation of regulatory accounts that are free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Independent auditor's report to Scottish Hydro Electric Power Distribution plc and to the Gas and Electricity Markets Authority ("GEMA" or the "Regulator") (*continued*)

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the regulatory accounts as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) and having regard to the guidance contained in ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts' issued by the Institute of Chartered Accountants in England & Wales will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the regulatory accounts.

As part of an audit in accordance with ISAs (UK) and having regard to the guidance contained in ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts' issued by the Institute of Chartered Accountants in England & Wales, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the regulatory accounts, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during the audit.
- Assess the reasonableness of significant accounting estimates and related disclosures made by the directors.

We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Standard Condition 44 of the Company's Regulatory Licence. Where Standard Condition 44 of the Company's Regulatory Licence does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the regulatory accounts are consistent with those used in the preparation of the statutory financial statements of the Company. Furthermore, as the nature, form and content of regulatory accounts are determined by the regulator, we did not evaluate the overall adequacy of the presentation of the information which would have been required if we were to express an audit opinion under International Standards on Auditing (UK and Ireland).

The purpose of our audit work and to whom we owe our responsibilities

This report is made, on terms that have been agreed, solely to the Company and the Regulator in order to meet the requirements of Standard Condition 44 of the Company's Regulatory Licence. Our audit work has been undertaken so that we might state to the Company and the Regulator those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under the Companies Regulatory Licence to procure such a report and (b) to facilitate the carrying out by the Regulator of its regulatory functions, 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 Regulator, for our audit work, for this report, or for the opinions we have formed.

Independent auditor’s report to Scottish Hydro Electric Power Distribution plc and to the Gas and Electricity Markets Authority (“GEMA” or the “Regulator”) (*continued*)

Our opinion on the regulatory accounts is separate from our opinion on the statutory financial statements of the Company. Our audit report in relation to the statutory financial statements of the Company (our “statutory” audit) was made solely to the Company members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our statutory audit work was undertaken so that we might state to the Company those matters which we required to state to them in a statutory auditor’s report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company’s members, as a body, for our statutory audit work, for any statutory audit work, for our statutory audit report, or for the opinions we have formed in respect of that statutory audit.

Gordon Herbertson (Senior Statutory Auditor)
For and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
319 St Vincent Street
Glasgow
G2 5AS

25 July 2018

Scottish Hydro Electric Power Distribution plc

Profit and Loss Account
for the year ended 31 March 2018

	Note	2018 £m	2017 £m
Turnover		**371.5**	382.5
Cost of sales		**(48.4)**	(49.7)
Gross profit		**323.1**	332.8
Distribution costs		**(179.0)**	(197.6)
Administrative costs		**(15.0)**	(14.5)
Operating profit	2	**129.1**	120.7
Interest receivable and similar income	4	**10.9**	-
Interest payable and similar charges	5	**(50.1)**	(34.8)
Profit before taxation		**89.9**	85.9
Tax on profit	6	**(14.9)**	(13.3)
Profit for the financial year		**75.0**	72.6

Continuing operations

The above results are derived from continuing activities.

The accompanying notes are an integral part of these regulatory financial statements.

Scottish Hydro Electric Power Distribution plc

Statement of Other Comprehensive Income
for the year ended 31 March 2018

	2018	2017
	£m	£m
Profit for the financial year	**75.0**	72.6
Other comprehensive income		
Loss on effective portion of cash flow hedges	**-**	(0.4)
Taxation on cashflow hedges	**-**	0.1
Other comprehensive income (loss)	**-**	(0.3)
Total comprehensive income relating to the financial year	**75.0**	72.3

Scottish Hydro Electric Power Distribution plc

Balance Sheet
as at 31 March 2018

	Note	2018 £m	Restated (note 1) 2017 £m
Fixed assets			
Tangible fixed assets	8	**1,159.5**	1,134.4
Intangible assets	9	**17.7**	12.7
		1,177.2	1,147.1
Current assets			
Stocks	10	**6.0**	10.5
Debtors:			
amounts falling due within one year	11	**51.4**	53.4
Total current assets		**57.4**	63.9
Current liabilities			
Creditors: amounts falling due within one year	12	**(156.2)**	(173.1)
Net current liabilities		**(98.8)**	(109.2)
Total assets less current liabilities		**1,078.4**	1,037.9
Creditors: amounts falling due after more than one year	13	**(766.5)**	(772.0)
Derivative financial liabilities	18	**(6.3)**	(17.2)
Deferred taxation	15	**(68.1)**	(67.7)
Net assets		**237.5**	181.0
Capital and reserves			
Called up share capital	16	**62.0**	62.0
Profit and loss account		**176.1**	119.6
Hedge reserve		**(0.6)**	(0.6)
Equity Shareholders' funds		**237.5**	181.0

These regulatory financial statements were approved by the Directors on 18 July 2018 and signed on their behalf by:

Gregor Alexander
Director
Company registered number: SC213460

Scottish Hydro Electric Power Distribution plc

Statement of Changes in Equity
for the year ended 31 March 2018

	Share capital £m	Retained earnings £m	Hedge reserve £m	Total equity £m
Balance at 1 April 2016	**62.0**	**96.1**	**(0.3)**	**157.8**
Profit for the financial year	-	72.6	-	**72.6**
Credit in respect of employee share awards	-	0.9	-	**0.9**
Dividends paid (note 7)	-	(50.0)	-	**(50.0)**
Other comprehensive income	-	-	(0.3)	**(0.3)**
Balance at 31 March 2017	**62.0**	**119.6**	**(0.6)**	**181.0**
Balance at 1 April 2017	**62.0**	**119.6**	**(0.6)**	**181.0**
Profit for the financial year	-	75.0	-	**75.0**
Credit in respect of employee share awards	-	1.5	-	**1.5**
Dividends paid (note 7)	-	(20.0)	-	**(20.0)**
Other comprehensive income	-	-	-	**-**
Balance at 31 March 2018	**62.0**	**176.1**	**(0.6)**	**237.5**

Scottish Hydro Electric Power Distribution plc

Cash Flow Statement
for the year ended 31 March 2018

	Note	2018 £m	Restated 2017 £m
Cash flows from operating activities			
Profit for the year		**75.0**	72.6
Add back: taxation		**14.9**	13.3
Add back: net finance costs		**39.2**	34.8
Operating profit		**129.1**	120.7
Depreciation on tangible fixed assets		**85.6**	103.0
Amortisation of intangible assets		**1.7**	1.3
Impairment of intangible assets		**1.6**	-
Customer contribution and capital grants released		**(3.3)**	(3.5)
Decrease in stocks		**4.5**	1.9
Decrease in debtors		**0.8**	3.5
Decrease in creditors		**(27.5)**	(31.2)
Movement in intercompany		**5.4**	38.2
Charge in respect of employee share awards		**1.5**	0.9
Net cash inflow from operating activities		**199.4**	234.8
Interest paid		**(44.6)**	(30.0)
Returns on investments and servicing of finance		**(44.6)**	(30.0)
Corporation tax paid		**(15.7)**	(14.5)
Taxation		**(15.7)**	(14.5)
Purchase of tangible fixed assets		**(110.8)**	(133.4)
Expenditure on intangible assets		**(8.3)**	(6.9)
Capital expenditure and financial investment		**(119.1)**	(140.3)
Equity dividends paid	7	**(20.0)**	(50.0)
Net cash inflow before management of liquid resources and financing		-	-
Reconciliation of net cash flow to movement in net funds			
Increase/(decrease) in cash in the year		**-**	-
Net funds at start of the year		**-**	-
Net funds at end of the year		**-**	-

Notes on the regulatory financial statements
for the year ended 31 March 2018

1 Significant accounting policies

The Company is a public company incorporated, domiciled, and registered, in Scotland. Its registration number is SC213460, and registered office is Inveralmond House, 200 Dunkeld Road, Perth, PH1 3AQ.

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's regulatory financial statements.

Basis of preparation
The regulatory financial statements have been prepared in accordance with all applicable United Kingdom accounting standards. The principal accounting policies are summarised below and have been applied consistently.

In preparing these regulatory financial statements, the Company has applied the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU ('Adopted IFRS'), but has made amendments, where necessary, in order to comply with the Companies Act 2006 and has set out below where advantages of the FRS 101 disclosure exemptions has been taken.

In these regulatory financial statements, the Company has applied the exemptions available under FRS 101 in respect of the following disclosures:
- The effect of new, but not yet effective, IFRSs; and
- Comparative period reconciliations for tangible fixed assets, intangible assets and share capital.

As the consolidated regulatory financial statements of SSE plc include the equivalent disclosure, the Company has also taken advantage of the exemptions, under FRS 101, available in respect of the following disclosures:
- Certain disclosures, required by IAS 36 *Impairment of assets,* in respect of the impairment of goodwill and intangible assets; and
- Certain disclosures, required by IFRS 13 *Fair Value Measurement* and IFRS 7 *Financial Instruments Disclosure.*

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these regulatory financial statements.

The company has not included employee share based payments disclosures on the basis of materiality.

The accounts have been prepared on a going concern basis. See the Corporate Governance Statement at page 13 for details of the Directors' assessment that the Company has adequate resources for the foreseeable future.

Turnover
Turnover from use of electricity networks is derived from the allowed revenue as defined by the parameters in the distribution licence regulations, which informs the tariffs we set. Revenue recognised is based on the volume of electricity distributed and the set customer tariff. Where this revenue differs from the allowed revenue, there may be an over- or under-recovery of revenue which will be reflected in future financial year's allowed revenue as set out in the regulatory licence and relevant industry codes. No accounting adjustment is made for over- or under-recoveries in the year that they arise. Turnover includes an estimate of the value of electricity distribution services provided to customers between the date of the last meter reading and the year end. In addition, turnover is also recognised on the value of customer contributions towards new connections, diversions and modifications to existing networks that occurred in the year.

Where the Company has an ongoing obligation to provide services, revenues are recognised as the service is performed and amounts billed in advance are treated as deferred income and excluded from current revenue. For network connections activity from 1 April 2014, the revenue recognition rules of IFRIC 18 have been applied as a result of the transition to FRS 101. Income is recognised on completion of the associated capital works.

1 Significant accounting policies (*continued*)

Foreign currencies
Transactions in foreign currencies are translated to the Company's functional currencies at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated to the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the profit and loss account except for differences arising on the retranslation of qualifying cash flow hedges, which are recognised in other comprehensive income.

Research
Expenditure on research activities is recognised in the profit and loss account as an expense as incurred.

Taxation
Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the profit and loss account except to the extent that it relates to items recognised directly in equity or other comprehensive income, in which case it is recognised directly in equity or other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

Tangible fixed assets
Tangible fixed assets are stated at cost less accumulated depreciation and accumulated impairment losses.

Depreciation is charged to the profit and loss account on a straight-line basis over the estimated useful lives of each part of an item of tangible fixed assets. The estimated useful lives are as follows:

	Years
Network assets	5 to 80
Non-operational assets:	
Fixtures, equipment, plant and machinery, vehicles and mobile plant	5 to 10

An item of property, plant and equipment (PPE) is derecognised on disposal. Where no future economic benefits are expected to arise from the continued use of an item of PPE, the asset is fully written off.

Assets under the course of construction are transferred to the corresponding asset category in the month following expenditure.

Expenditure incurred to replace a component of a tangible fixed asset that is accounted for separately is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits of the tangible fixed asset to which it relates.

1 Significant accounting policies *(continued)*

Intangible assets
Intangible assets are stated at cost less accumulated amortisation and accumulated impairment losses.

Included within intangible assets are application software license fees, software development work, software upgrades and purchased PC software packages. Amortisation is over 10 years. The carrying amounts of the Company's intangible assets are reviewed at each reporting date to determine whether there is any indication of impairment. Where indicators of impairment are identified, the carrying value of those assets is compared to the recoverable amount. An impairment loss is recognised where it is considered that recoverable amounts are less than the carrying value of those assets.

Capitalised interest
Interest directly attributable to the acquisition, construction or production of major capital projects, which are projects that necessarily take a substantial period of time to get ready for their intended use, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use, and depreciated as part of the total cost over the useful life of the asset.

Customer contributions
Customer contributions towards construction or acquisition of new Out-of-Area networks, and capital grants received pre 1 April 2014, are recorded as deferred income and released to the profit and loss account over the estimated life used in calculating contributions. Deferred income also includes outstanding balances of customer contributions on new connections to existing networks pre business separation in 2001. Where there is no ongoing service obligation, customer contributions received post 1 April 2014 are taken to income in the period, in line with IFRIC 18 *Transfers of assets from customers*.

Operating leases
Payments made under operating leases are recognised in the profit and loss account on a straight-line basis over the term of the lease.

Stocks
Stocks are stated at the lower of cost and net realisable value. The valuation of work in progress is based on the cost of direct labour and material plus attributable overhead.

Pensions
Some of the Company's employees are members of a group wide defined benefit pension plan. As there is no contractual agreement or stated group policy for charging the net defined benefit cost of the plan to participating entities, the net defined benefit cost of the pension plan is recognised fully by the sponsoring employer, which is another member of the group. The Company then recognises a cost equal to its contribution payable for the period. Obligations for contributions to defined contribution pension plans are recognised as an expense in the profit and loss account in the periods during which services are rendered by employees.

Equity and equity-related compensation benefits
SSE plc, the ultimate parent of the Company, operates a number of All Employee Share Schemes as described in the Remuneration Report of the Group. These schemes enable Group employees to acquire shares of the ultimate parent company. The employees of the Company are entitled, where applicable, to participate in these schemes. The Company has not been charged with the cash cost of acquiring shares on behalf of its employees, this cost is borne by the Ultimate Parent Company. Where the fair value of the options granted has been measured, the Company has recognised the expense as if the share based payments related to the Company's own shares.

The exercise prices of the sharesave scheme are set at a discount to market price at the date of the grant. The fair value of the sharesave scheme option granted is measured at the grant date by use of an option pricing model. The fair value of the options granted is recognised as an expense on a straight-line basis over the period that the scheme vests. Estimates are updated at each balance sheet date with any adjustment in respect of the current and prior years being recognised in the profit and loss account. The costs associated with the other main employee schemes, the share incentive plan and the deferred bonus scheme, are recognised over the period to which they relate.

1 Significant accounting policies *(continued)*

Recognition of profits on contracts
Profit is recognised on long-term contracts on completion of the total contract. Provision is made for foreseeable losses.

Derivative financial instruments and hedging
Derivative financial instruments are recognised at fair value. The gain or loss on re-measurement to fair value is recognised immediately in profit or loss. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged.

Prior period adjustments
Following a review of the comparative period, it was identified that an allocation error had offset the ongoing costs and Deferred Income as at 31 March 2017 which is not in line with accounting standards. The costs were previously offset against Deferred income and an adjustment has been made to re-present these costs as either Assets under construction or Work in progress. Work in progress relates to costs incurred on non-capital networks projects. These projects are performed at the customer's request and are paid for in full directly by the customer. They do not therefore contribute additional value to the network. A corresponding adjustment has been made to the deferred income balance which is now presented gross. There has been no change to profit and loss or net assets as a result of this adjustment.

During this review it was also identified that a reallocation was required to opening balances as certain Networks assets had been classified as Miscellaneous assets. This £11.7m reallocation to cost and £1.6m reallocation to accumulated depreciation has been reflected in note 8 and there has been no change to Fixed assets NBV as a result of this adjustment. Refer to note 8 for categorisation within Tangible fixed assets.

	Note	As previously reported £m	Adjustments £m	As restated £m
Tangible fixed assets NBV	8	1,080.7	53.7	**1,134.4**
Stocks	10	2.5	8.0	**10.5**
Accruals and deferred income due within one year	12	(46.1)	(39.8)	**(85.9)**
Accruals and deferred income after more than one year	13	(96.0)	(21.9)	**(117.9)**
		941.1	-	**941.1**

This adjustment also has an impact on the Cash Flow statement as follows:

	As previously reported £m	Adjustments £m	As restated £m
Purchase of tangible fixed assets	(147.9)	14.5	**(133.4)**
Decrease in stock	-	1.9	**1.9**
Decrease in creditors	(14.8)	(16.4)	**(31.2)**

The adjustment to tangible fixed assets also has an impact on the Regulatory segmental analysis note. This relates to Excluded Services Capital additions as shown below.

	As previously reported £m	Adjustments £m	As restated £m
Capital Additions – tangible (Excluded Services)	40.2	(14.5)	**25.7**

2 Expenses and auditor's remuneration

Operating profit is arrived at after charging/(crediting):

	2018 £m	2017 £m
Depreciation of tangible fixed assets	**85.6**	103.0
Amortisation of intangible assets	**1.7**	1.3
Impairment of intangible assets	**1.6**	-
Operating lease rentals	**5.4**	4.7
Release of deferred income in relation to customer contributions and capital grants	**(3.3)**	(3.5)
Net management fees in respect of services provided by group companies	**13.6**	13.3
Research costs	**0.6**	1.1

The Company incurred an audit fee of £0.03m *(2017: £0.05m)* and audit-related assurance service fees of £0.04m *(2017: £0.03m)* in the year.

3 Staff costs and numbers

	2018 £m	2017 £m
Staff costs:		
Wages and salaries	**52.5**	49.6
Social security costs	**5.7**	5.3
Share based remuneration	**1.5**	0.9
Pension costs	**16.2**	18.7
	75.9	74.5
Less charged as capital expenditure	**(24.6)**	(25.5)
	51.3	49.0

Included within the above is a Share-based payment charge of £1,451,623 *(2017: £894,385)*.

Employee numbers

	2018 Number	2017 Number
Numbers employed at 31 March	**1,382**	1,276

	2018 Number	2017 Number
The monthly average number of people employed by the Company during the year	**1,374**	1,255

	2018 £m	2017 £m
Directors remuneration	**0.8**	0.9

The aggregate of remuneration and amounts receivable under long term incentive schemes of the highest paid director was £0.5m *(2017: £0.6m).*

	Number of directors 2018	2017
Retirement benefits are accruing to the following number of directors under:		
Defined benefit schemes	**1**	2

4 Interest receivable and similar income

	2018 £m	2017 £m
Movement on financing derivatives	**10.9**	-

5 Interest payable and similar charges

	2018 £m	2017 £m
Interest payable to group companies	**32.0**	27.1
Bank loans and overdrafts	**18.1**	6.8
Movement on financing derivatives	**-**	1.3
Interest capitalised	**-**	(0.4)
	50.1	34.8

6 Taxation

	2018 £m	2017 £m
UK corporation tax		
Current tax on income for the period	**17.1**	17.1
Adjustment in respect of prior periods	**(2.6)**	(1.2)
Total current tax charge	**14.5**	15.9
Deferred tax (see note 15):		
Origination and reversal of temporary differences	**0.1**	0.2
Adjustment in respect of prior periods	**0.3**	1.2
Effect of change in tax rate	**-**	(4.0)
Total deferred tax	**0.4**	(2.6)
Total tax on profit	**14.9**	13.3

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

6 Taxation *(continued)*

	2018	2017
	£m	£m
Profit before taxation	**89.9**	85.9
Tax on profit at standard UK corporation tax rate of 19% *(2017: 20%)*	**17.1**	17.2
Effects of:		
Adjustment in respect of previous periods	**(2.3)**	-
Other items	**0.1**	0.1
Effect of change in tax rate on deferred tax	**-**	(4.0)
Total tax charge for year	**14.9**	13.3

The standard rate of tax applied to reported profit on ordinary activities is 19% *(2017: 20%)*. Legislation to reduce the corporation tax rate from 20% to 19% from 1 April 2017 and to 18% from 1 April 2020 was substantively enacted on 26 October 2015. Legislation was substantively enacted on 15 September 2016 to further reduce the corporation tax rate to 17% from 1 April 2020. As these changes were substantively enacted at 31 March 2017 deferred tax was calculated accordingly and has had the effect of reducing the company's deferred tax liability at 31 March 2018 by nil *(2017: £4.0m)*.

7 Dividends

	2018	2017
	£m	£m
Amounts recognised as distributions from equity:		
Final dividend of 32.2p (2017 – 80.6p) per share	**20.0**	50.0

The final dividend for the current year, £20.0m (*2017*: *£50m*), was declared and approved on 21 September 2017 and was paid to shareholders on 29 September 2017. The final dividend for the previous year was approved on 23 February 2017 and paid to shareholders on 31 March 2017.

8 Tangible Fixed Assets

	Network Assets	**Assets under the course of construction (AUC)**	**Vehicles and miscellaneous equipment**	**Total**
	£m	**£m**	**£m**	**£m**
Cost:				
At 1 April 2017 as previously presented	2,069.9	3.0	91.2	2,164.1
Adjustment	11.7	53.7	(11.7)	53.7
Restated At 1 April 2017 (note 1)	2,081.6	56.7	79.5	2,217.8
Additions	-	110.7	-	110.7
Transfers from AUC to fully commissioned	127.2	(127.9)	0.7	-
Transfers between categories	(2.2)	-	2.2	-
At 31 March 2018	**2,206.6**	**39.5**	**82.4**	**2,328.5**
Accumulated depreciation:				
At 1 April 2017 as previously presented	(1,016.5)	-	(66.9)	(1,083.4)
Adjustment	(1.6)	-	1.6	-
Restated At 1 April 2017 (note 1)	(1,018.1)	-	(65.3)	(1,083.4)
Charge for the year	(82.7)	-	(2.9)	(85.6)
At 31 March 2018	**(1,100.8)**	**-**	**(68.2)**	**(1,169.0)**
Net book value:				
At 31 March 2018	**1,105.5**	**39.5**	**14.5**	**1,159.5**
At 31 March 2017	1,063.2	56.7	14.5	1,134.4

8 Tangible Fixed Assets *(continued)*

The above tangible fixed assets include £1.4m *(2017: £1.4m)* of capitalised interest. There was no capitalised interest in the current year *(2017: £0.4m)*. This is depreciated annually according to the useful economic life of the asset to which the capitalised interest relates.

9 Intangible assets

	£m
Cost:	
At 1 April 2017	14.3
Additions	8.3
At 31 March 2018	**22.6**
Amortisation:	
At 1 April 2017	(1.6)
Charge for the year	(1.7)
Impairment for the year	(1.6)
At 31 March 2018	**(4.9)**
Net book value:	
At 31 March 2018	**17.7**
At 31 March 2017	12.7

Management performed a review of capitalised IT costs at year end, resulting in a one-off impairment charge within intangible assets of £1.6m (*2016/17: nil*). This impairment was recognised in relation to projects which are no longer providing value to the Company.

10 Stocks

	2018 £m	Restated (note 1) 2017 £m
Raw materials and consumables	**1.8**	2.5
Work in progress	**4.2**	8.0
	6.0	10.5

Work in progress relates to costs incurred on non-capital networks projects. These projects are performed at the customer's request and are paid for in full directly by the customer. They do not therefore contribute additional value to the network. The projects are partially completed at the financial year end, the costs being recognised as work in progress and the related income received from the customer being held within deferred income liabilities at the balance sheet date.

11 Debtors

	2018 £m	2017 £m
Trade debtors	**9.3**	11.2
Prepayments and accrued income	**31.8**	30.7
Amounts owed by group undertakings	**10.3**	11.5
	51.4	53.4

Notes on the regulatory financial statements *(continued)*
for the year ended 31 March 2018

12 Creditors: amounts falling due within one year

	2018 £m	Restated (note 1) 2017 £m
Trade creditors	**0.9**	2.2
Amounts owed to group undertakings	**52.2**	63.6
Other creditors	**13.5**	11.7
Corporation tax payable	**8.6**	9.7
Accruals and deferred income	**81.0**	85.9
	156.2	173.1

13 Creditors: amounts falling due after more than one year

	2018 £m	Restated (note 1) 2017 £m
Loans and borrowings (note 14)	**137.7**	132.7
Loans due to ultimate parent (note 14)	**300.0**	300.0
Accruals and deferred income	**91.8**	117.9
Amounts owed to group undertakings	**237.0**	221.4
	766.5	772.0

14 Interest bearing loans and borrowings

This note provides information about the contractual terms of the Company's interest bearing loans and borrowings which are held at amortised cost.

	Weighted Average Interest Rate 2018 %	Weighted Average Interest Rate 2017 %	**2018 £m**	2017 £m
Creditors: falling due between two and five years				
5.90% Loan Stock repayable to SSE plc on 31 March 2022	**5.90**	5.90	**300.0**	300.0
Creditors: falling due more than five years				
1.4296% Index linked bond repayable on 20 October 2056	**1.99**	1.92	**137.7**	132.7
			437.7	432.7

15 Deferred taxation

Deferred tax assets and liabilities are attributable to the following:

	Assets		**Liabilities**		**Net**	
	2018	2017	**2018**	2017	**2018**	2017
	£m	£m	**£m**	£m	**£m**	£m
Accelerated capital allowances	**-**	-	**68.1**	67.7	**68.1**	67.7
Net tax liabilities	-	-	**68.1**	67.7	**68.1**	67.7

	1 April 2017	**Recognised in income**	**Recognised in equity**	**31 March 2018**
	£m	**£m**	**£m**	**£m**
Movement in deferred tax during the year	67.7	0.4	-	**68.1**

	1 April 2016	Recognised in income	Recognised in equity	31 March 2017
	£m	£m	£m	£m
Movement in deferred tax during prior year	70.4	(2.6)	(0.1)	67.7

No deferred tax arises on derivatives as the accounting base is the same as the tax base.

16 Share capital

	2018	2017
	£m	£m
Equity:		
Allotted, called up and fully paid:		
62,000,000 ordinary shares of £1.00 each	**62.0**	62.0

17 Pensions

13% *(2017: 21%)* of the Company's employees are members of the Scottish Hydro-Electric Pension Scheme which provides defined benefits based on final pensionable pay. As there is no contractual agreement or stated group policy for charging the net defined benefit cost of the plan to participating entities, the net defined benefit cost of the pension plan is recognised fully by the sponsoring employer, which is another member of the group.

New employees can join a personal pension scheme which is a money purchase scheme with the Company matching the members' contributions up to a maximum of 6% of salary. The scheme is managed by Aviva.

The Company's share of the total contribution payable to the pension schemes during the year was £12.6m *(2017: £10.7m)*. In addition to this, the Company incurred a further charge, payable to SSE Services plc, of £3.6m *(2017: £8.0m)*, which related to its share of the Scheme's deficit repair contributions for the year ended 31 March 2018.

18 Derivatives and financial instruments

Exposure to interest rate risk arises in the normal course of the Company's business. Derivative financial instruments are entered into to hedge exposure to risk. The objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the year are explained below.

The Group's Treasury department is responsible for managing the banking and liquidity requirements of the Company, risk management relating to interest rate and foreign exchange exposures, and for managing the credit risk relating to the banking counterparties with which it transacts. The department's operations are governed by policies determined by the Group's Executive Committee and any breaches of these policies are reported to the Tax and Treasury Committee and the Group's Audit Committee.

(i) Risk

Interest rate risk
Interest rate risk derives from the Company's exposure to changes in value of an asset or liability or future cash flows through changes in interest rates.

The Company's policy is to manage this risk by stipulating that a minimum of 50% of borrowings be subject to fixed rates of interest, either directly through the debt instruments themselves or through the use of derivative financial instruments. The floating rate borrowings are provided by banks including the European Investment Bank (EIB). Such instruments include interest rate swaps. These practices serve to reduce the volatility of the Company's financial performance.

Although interest rate derivatives are primarily used to hedge risk relating to current borrowings, under certain circumstances they may also be used to hedge future borrowings. Any such pre-hedging is unwound at the time of pricing the underlying debt, either through cash settlement on a net present value basis or by transacting offsetting trades. The floating rate borrowings mainly comprise cash advances from the EIB.

The impact of a change in interest rates is dependent on the specific details of the financial asset or liability in question. Changes in fixed rate financial assets and liabilities, which account for the majority of cash, loans and borrowings, are not measured at fair value through the income statement. In addition to this, changes to fixed-to-floating hedging instruments which are recorded under cash flow hedge accounting also do not impact the income statement. Changes in variable rate instruments and hedging instruments and hedged items recorded under fair value hedge accounting are recorded through the income statement. The exposure measured is therefore based on variable rate debt and instruments.

Effective interest rate analysis
In respect of income earning financial assets and interest bearing financial liabilities, the following table indicates their effective interest rates as at the balance sheet date and the periods in which they re-price or mature:

At 31 March 2018

	Effective interest rate %	**Total £m**	Within 1 year £m	1 - 2 years £m	2 - 5 years £m	More than 5 years £m
Long term bonds	**1.9922**	**137.7**	-	-	-	137.7
Loan stock	**5.9000**	**300.0**	-	-	300.0	-

18 Derivatives and financial instruments (*continued*)

(ii) Fair values

The fair values of the Company's financial assets and financial derivatives, and the carrying amounts in the balance sheet are analysed below. Balances included in the analysis of primary financial assets and liabilities include cash and cash equivalents, loans and borrowings, trade debtors and trade creditors, all of which are disclosed separately.

Summary fair values
The fair values of the primary financial assets and liabilities together with their carrying values are as follows:

	2018 Carrying value £m	**2018 Fair Value £m**	2017 Carrying value £m	2017 Fair Value £m
Financial Assets				
Trade and intercompany debtors	**19.6**	**19.6**	22.7	22.7
Financial Liabilities				
Trade and intercompany creditors	**53.1**	**53.1**	65.8	65.8
Long-term intercompany	**237.0**	**237.0**	221.4	221.4
Loans and borrowings	**137.7**	**236.7**	132.7	242.7
Loans due to ultimate parent	**300.0**	**347.0**	300.0	366.2
Derivative financial liabilities	**6.3**	**6.3**	17.2	17.2

Fair values have been determined with reference to closing market prices. Unless otherwise stated, carrying value approximates fair value.

Financial derivative instruments - disclosure
For disclosure purposes, derivative financial instruments are classified as financing derivatives. The company utilises financing derivatives in the form of interest rate derivatives. Non-hedge accounted contracts are treated as held for trading (MTM). The carrying value is the same as the fair value for all instruments. All balances are stated gross of associated deferred taxation.

Basis of determining fair value
Closing rate market values have been used to determine the fair values of the interest rate and denominated long-term fixed rate debt. Estimates applied reflect the management's best estimates of these factors.

19 Capital commitments

	2018 £m	2017 £m
Contracted but not provided for	**17.4**	13.8

20 Operating lease commitments

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

	2018 Land & Buildings £m	**2018 Other £m**	2017 Land & Buildings £m	2017 Other £m
Operating leases which expire:				
Within one year	**0.5**	**4.4**	0.5	4.8
Between two and five years	**1.9**	**6.6**	1.9	8.4
In more than five years	**8.0**	**0.4**	3.8	0.3
	10.4	**11.4**	6.2	13.5

20 Operating lease commitments (*continued*)

Leases as Lessee:

	2018	2017
	£m	£m
Amount included in the profit and loss account relating to the current year leasing arrangements	**5.4**	4.7

21 Commitments and contingencies

The Company has provided a guarantee in relation to £300m Euro bonds (expiry 2022) held by the Group. This guarantee has been provided jointly with Scottish Hydro Electric Transmission plc.

22 Net debt

	2018	2017
Reconciliation of net cash flow to movement in net debt	**£m**	£m
Other non-cash movement	**(5.0)**	(2.3)
Movement in net debt in the year	**(5.0)**	(2.3)
Net debt at 1 April	**(432.7)**	(430.4)
Net debt at 31 March	**(437.7)**	(432.7)

Analysis of net debt

	As at 1 April 2017	Increase in cash	Decrease in debt	Non-cash movements	**As at 31 March 2018**
	£m	£m	£m	£m	**£m**
Net borrowings due after more than one year	(432.7)	-	-	(5.0)	**(437.7)**

23 Related undertakings

The related undertakings in which the Company has a shareholding are listed below:

Company Name	**Relation**	**Country of incorporation**	**Registered address (key)**	**2018 Holding %**	2017 Holding %	**Principal activity**
Electralink Limited	Investment	England and Wales	B	**4.89**	4.89	Data Transfer Service Operator
Gemserv Limited	Investment	England and Wales	A	**2.78**	2.78	Market Design, Governance and Assurance Service Provider
DCUSA Limited	Investment	England and Wales	B	**1.69**	1.69	Billing Framework Operator
MRA Service Company Limited	Investment	England and Wales	A	**0.45**	0.61	Metering Point Administration Services Operator
Smart Energy Code Company Limited	Investment	England and Wales	A	**0.39**	0.54	Smart Metering Implementation Management

Registered Address Key

Address	**Reference**
8 Fenchurch Place, London, EC3M 4AJ	A
Northumberland House, 303 - 306 High Holborn, London, England, WC1V 7JZ	B

24 Regulatory segmental analysis

For the year to 31 March 2018:

	Distribution (DUoS) £m	Excluded Services [i] £m	Metering [ii] £m	Out of Area Networks £m	De Minimis [iii] £m	**Total £m**
Revenue	303.5	51.9	1.8	6.6	7.7	**371.5**
Operating Costs	(131.9)	(15.1)	-	(2.1)	(7.7)	**(156.8)**
Depreciation	(47.0)	(35.4)	(0.4)	(2.8)	-	**(85.6)**
Capital contributions release	2.8	-	-	0.5	-	**3.3**
	(1.6)	-	-	-	-	**(1.6)**
Amortisation	(1.7)	-	-	-	-	**(1.7)**
Operating Profit	**124.1**	**1.4**	**1.4**	**2.2**	**-**	**129.1**
Capital additions - tangible	**88.3**	**18.3**	**-**	**4.1**	**-**	**110.7**
Capital additions – intangible	**8.3**	**-**	**-**	**-**	**-**	**8.3**

24 Regulatory segmental analysis (*continued*)

For the year to 31 March 2017:

	Distribution (DUoS)	Excluded Services (i)	Metering (ii)	Out of Area Networks	De Minimis (iii)	**Total**
	£m	£m	£m	£m	£m	**£m**
Revenue	313.4	57.6	1.8	3.2	6.5	**382.5**
Operating Costs	(133.6)	(16.2)	-	(1.1)	(6.5)	**(157.4)**
Depreciation	(61.8)	(40.2)	(0.4)	(0.6)	-	**(103.0)**
Amortisation	(1.4)	-	-	-	-	**(1.4)**
Operating Profit	**116.6**	**1.2**	**1.4**	**1.5**	**-**	**120.7**
Capital additions - tangible	**100.1**	***25.7**	**-**	**3.1**	**-**	**128.9**
Capital additions – intangible	**6.9**	**-**	**-**	**-**	**-**	**6.9**

(i) Excluded services includes connections, diversions and other excluded services as defined in the licence (ES1, ES3 and ES7).
(ii) Metering services refer to Legacy MAP only.
(iii) De Minimis activities primarily relate to activities undertaken on behalf of other SSE plc Group companies.
* Prior year additions have been adjusted to reflect the re-presentation of Assets Under Construction. See Note 1.

25 Regulated related party disclosure

For the year to 31 March 2018:

Type of transaction	Ultimate parent (SSE plc) £m	Immediate parent (SSEPD)(i) £m	Other SSE plc Group companies £m
Sales and provision of services	-	-	100.0
Purchases and receipt of services	-	-	(37.6)
Distribution of dividends	-	(20.0)	-
Finance costs (note 5)	(32.0)	-	-

For the year to 31 March 2017:

Type of transaction	Ultimate parent (SSE plc) £m	Immediate parent (SSEPD)(i) £m	Other SSE plc Group companies £m
Sales and provision of services	-	-	109.0
Purchases and receipt of services	-	-	(42.6)
Distribution of dividends	-	(50.0)	-
Finance costs (note 5)	(27.1)	-	-

(i) The immediate parent of the Company is Scottish and Southern Energy Power Distribution Limited (SSEPD).
(ii) Balances outstanding to and from Group companies including the Ultimate and Immediate Parent Companies are disclosed in Notes 11, 12, 13 and 14 to these regulatory financial statements.

26 Ultimate parent company

The Company is a subsidiary of SSE plc, which is the ultimate parent company and is registered in Scotland. The largest and smallest Group in which the results of the Company are consolidated is that headed by SSE plc. The consolidated financial statements of the Group (which include those of the Company) are available from the Company Secretary, SSE plc, Inveralmond House, 200 Dunkeld Road, Perth, PH1 3AQ or by accessing the Company's website at www.sse.com.