Company Registration Number: 10615396

Quadgas MidCo Limited

Annual Report and Financial Statements

For the year ended 31 March 2019

Quadgas MidCo Limited
Strategic Report
For the year ended 31 March 2019

The Directors present their Strategic Report on the Quadgas MidCo Limited Consolidated Financial Statements for the year ended 31 March 2019.

Principal activities
Quadgas MidCo Limited (the company) holds investments in a number of Quadgas HoldCo Limited (its indirect parent company) subsidiary companies and obtains and provides finance to fellow subsidiary companies via intercompany balances.

The Group comprises Quadgas MidCo Limited, Quadgas Finance Plc, Cadent Services Limited, Cadent Finance Plc and Cadent Gas Limited. Cadent Gas Limited is the main trading company and operates four of the eight regional gas distribution networks in Great Britain; supplying gas to 11 million customers across the four networks and managing the national gas emergency service free phone line, taking calls and giving safety advice on behalf of the UK gas industry.

Strategy
The Group's strategy is to set new standards on the quality of the services we deliver to all of our customers, stakeholders and communities, particularly those that find themselves in vulnerable situations. We need to develop a customer first approach that has an ethos of constantly maintaining availability of gas supplies to our customers by developing appropriate techniques and using innovative ways to achieve this goal. We will also push the boundaries on our role in supporting safety of customers in the home, helping alleviate fuel poverty and making our services more accessible to all types of customer.

Future developments
Our focus, through our main trading company, will remain on driving the performance of the business to deliver strong Group returns and increasing the value to our equity holders including efficiently financing the Group.

To achieve this, Cadent Gas Limited (Cadent Gas), our regulated business, will continue looking for ways to optimise performance. In 2019/20 we'll continue to work closely with Ofgem to develop a RIIO-2 framework which will create value for customers and investors. The performance of our regulated business will be underpinned by continued investment so we can make sure we deliver a safe, reliable and affordable service for our customers.

Business environment
The Group manages the gas distribution networks to keep the gas flowing safely and reliably to help keep our 11 million customers connected, safe and warm. The Group are incentivised through Ofgem's regulatory framework called RIIO (Revenue = Incentives + Innovation + Output) to operate efficiently and deliver services that our customers and stakeholders value. These are expressed as output commitments across six key categories (safety, reliability, environment, social obligations, customers satisfaction and facilitating connections).

The regulator, Ofgem, safeguards customers' interests by setting the level of charges we are allowed to recover associated with the output commitments we must deliver. Ofgem is able to make comparisons across all eight gas distribution networks. The output targets are defined such that Cadent Gas maintains safe and reliable networks; make a positive contribution to sustainability and protect the environment; provide connections to supply new consumers and support new gas entry points into the network; meet social obligations such as reducing fuel poverty and raising awareness of the dangers of carbon monoxide; and provide an agreed standard of service to consumers and other stakeholders.

Ofgem has started work on the RIIO-2 price control which will cover the 5 year period from 2021/2022 to 2025/2026. We continue to work closely with Ofgem to develop the framework and understand the impact on our business. Decisions already taken by Ofgem include a move from RPI to CPIH inflation of our RAV and a proposed methodology for the cost of equity that points to a value that is lower than the current RIIO-1 price control. Our financial risk management framework takes account of the impact of the uncertainties over the future price control settlement and we will continue to actively monitor and respond to the impacts of the price control process as it progresses.

Business environment (continued)

Cadent Gas collaborates with the industry on issues, such as innovation, safety and the future of networks to deliver outcomes that customers value.

Climate change and energy policy have arguably never been higher up in the public consciousness and the political agenda. There is a universal acknowledgement that meaningful action to decarbonise is required over the coming decades. We are leading that response by helping to inform and direct energy policy, particularly in the challenging areas of heat and transport. We are shaping the future energy landscape by working with stakeholders across national and local government, industry and investors. There are significant challenges in defining the UK's future energy mix with but also significant opportunities where energy solutions like hydrogen could see the UK becoming a global leader in clean green gas technology.

Group Priorities for the year ahead

Delivering a resilient network to keep the energy flowing safely and reliably	• New Multi occupancy buildings ('MOBS') operating model in London • Continued focus on mains replacement increased w orkload and step-up in asset health investment • 16,000 medium rise building surveys • Separation of Information Services (IS) systems from National Grid
Providing a quality experience to all of our customers, stakeholders and communities	• Continual improvement in restoration of supply in Multi Occupancy Buildings • Consistent Customer Satisfaction (CSAT) across all experiences (focus in planned w ork in West Midlands and connections in London) • Defining RIIO-2 outcomes and outputs • Focus on fuel poor connections in West Midlands and North West • Enhanced customer data techniques, including the application of Artificial Intelligence (AI) and machine learning to better understand customer insights and drive action • Transformation of operating model to netw ork aligned approach initiated • Culture change to enhance customer focus and productivity
Improving the environment and supporting the transition to a sustainable energy system	• Zero avoidable w aste to landfill strategy • Remove single use plastic in offices and depots • HyDeploy 2 project start to trial hydrogen blending on a public netw ork • 32 Biomethane connections expected • New compressed Natural Gas filling station connection in West Midlands • Future Billing Methodology Field Trials
Trusted to act for society	• Launch of Community Fund of 1.25% of post-tax profits • Continued Alzheimer's Society partnership • Further engaging locally w ith regional authorities • Supporting the Department for Transport developing a new street w orks noticing system

Revenue

Most of our revenue is set in accordance with our regulatory agreements. This is referred to as our 'allowed revenue' and is calculated based on a number of factors. These include:

- investment in network assets;
- operational "run the business" costs (including tax and pensions);
- performance against incentives;
- regulatory return on equity and cost of debt; and
- inflation adjustments.

Our allowed revenue gives us a level of certainty over future revenues if we continue to meet our output commitments as well as the efficiency and innovation targets included in the RIIO-1 price control.

Cash flow

Our ability to convert revenue to cash is an important factor in the ongoing reinvestment in our business. Securing low-cost funding, carefully managing our cash flows and efficient development of our networks are essential to maintaining strong sustainable returns for our shareholders. Cash generation is underpinned by our charging methodology (part of the industry's network code) which being a capacity based regime provides stability and predictability of cashflows.

Investment

We invest efficiently in our networks to deliver strong regulated asset growth over the long term. This drives additional future revenues, which in turn generates additional cash flows and allows us to continue reinvesting in our networks and providing sustainable dividends to our ultimate shareholders.

This approach is critical to the sustainability of our business. By challenging our investment decisions, we continue to deliver reliable, cost-effective networks that benefit our customers. The way in which our investment is funded is also an important part of our business. The long-term, sustainable nature of our assets and our credit ratings help us secure efficient funding from a variety of sources.

Consolidated Results

Income Statement

<u>Revenue</u>
Revenue was £1,986 million (2018: £1,852 million) driven by our regulatory allowed revenues which account for 95% of our revenue. Each year our revenues are largely fixed in line with the profile set out by our price control agreement which determines the pricing of our services to the gas shippers. Any differences between our allowed revenues and the amounts collected through our pricing are adjusted in future periods. Revenues for the year end ended 31 March 2019 include higher capacity income as a result of new connections, coupled with £53m higher non-regulatory income largely due to the £55m increase as a result of IFRS 15 'Revenue from Contracts with Customers'.

<u>Operating profit</u>
Operating profit pre exceptional items was £782 million (2018: £668 million) with operational expenditure largely comprised of depreciation, employment costs of our direct workforce and contract partners, business rates and charges associated with our usage of the National Grid Gas Transmission network. The increase in operating profit pre exceptional items is a result of increased revenues for the year ended 31 March 2019.

Operating loss after exceptional items was £623m (2018: £648m profit). The loss of £623m was largely driven by the goodwill impairment charged in the year of £1,372m.

<u>Exceptional items</u>
Exceptional costs of £1,405 million (2018: £20 million) were largely driven by a goodwill impairment charged in the year of £1,372m.

During the year, management completed the annual impairment test required for the goodwill and indefinite life intangibles that is holds on its balance sheet. The impairment test required the comparison of the carrying value of the net assets of income generating unit (Quadgas MidCo Limited) and its recoverable amounts. Management had been reviewing Ofgem announcements on RIIO-2 during the course of the year given the potential impact on the recoverable amount. When these proposed assumptions changes were factored in to the value in use calculation, together with the latest business plan cash flows, the value in use was significantly reduced and therefore an impairment required of £1,372m.

The remaining £33m exceptional costs within operating profit comprise amounts relating to separation activities, restructuring activities and guaranteed minimum pension. Cadent announced on 13 May 2019 that it was offering a voluntary redundancy programme for all managers and staff. The cost of this programme cannot be determined with certainty at this stage as the programme is subject to employee consultation with the period of consultation running to 26 June 2019. Management's current best estimate is a cost between £15m - £20m.

<u>Net finance costs</u>
Net finance costs before exceptional items and re-measurements of £248 million (2018: £269 million) were driven by interest on external debt funding. There were net £13 million (2018: £Nil) remeasurements arising from the changes in fair value of derivative financial instruments during the year.

<u>Taxation</u>
Our effective rate before exceptional items and remeasurements for the year is 18.4% (2018: 20.1%). The decrease in the effective rate reflects the increase in the deferred tax credit as a result of the increased deferred tax asset recognised on the land remediation provision. The effective tax rate after exceptional items is (10.2%) (2018 20.1%); this reflects the non-deductibility of the goodwill impairment.

In common with other utilities, we have a significant deferred tax provision that mainly relates to the benefits received in the past from tax allowances on capital expenditure before the depreciation on those assets has been charged to our profits. This provision is released to the income statement as the depreciation catches up with the tax allowances received. The provision is calculated at the rate of tax applicable when the provision is expected to reverse. During the year and in accordance with our obligations under Finance Act 2016 Schedule 19, we published our Tax Strategy Statement. We are committed to being a responsible and compliant taxpayer and the Tax Strategy Statement sets out our approach to a number of key tax policies including our approach to tax governance and risk management, our attitude towards tax planning, our risk appetite in relation to UK taxation and our approach to dealing with HMRC.

Statement of Financial Position

The consolidated statement of financial position sets out all the Group's assets and liabilities at the period end, analysed between the net assets we have for use in the business. As a capital-intensive business, we have significant amounts of physical assets and corresponding borrowings.

<u>Capital Investment</u>
Capital investment was £736m (2018: £612m) and is primarily associated with the ongoing gas mains replacement programme which saw 1,701km of mostly cast iron pipes replaced by polyethylene pipe during the year. The remaining capital investment at £267m (2018: £205m) was to maintain the integrity of our network infrastructure.

<u>Cashflow and net debt</u>
Borrowings (both current and non-current) at 31 March 2019 were £9,542 million (2018: £9,163 million) mainly comprised fixed rate and index linked debt.

Cashflow and net debt (continued)

Driven by the need to fund our capital investment programme, the Group has a material amount of debt, with regular maturities and requirements for new incremental debt, therefore the Group operates a pro-active policy of meeting credit investors and the Group's relationship banks regularly to provide updates and information to facilitate ongoing access to the capital markets.

As at 31 March 2019, Quadgas MidCo Limited was rated BBB+ (stable outlook) by S&P, with any notes issued by the company rated BBB (stable outlook).

Intangible assets

Goodwill of £1,940 million (2018: £3,312 million) has decreased due to an impairment charge of £1,372m during the year which was recognised within exceptional items in the income statement. Under the requirements of IAS 36, this impairment was allocated to the goodwill balance of the cash generating unit (the business of gas distribution at the total Quadgas MidCo Limited level) and an impairment loss of £1,372m was recognised against the goodwill balance. The impairment was driven by Ofgem announcements on RIIO-2 during the course of the year which had a significant impact on the recoverable amount. When these proposed assumptions changes were factored in to the value in use calculation, together with the latest business plan cash flows, the value in use was significantly reduced and therefore an impairment required of £1,372m.

The Group also holds a balance of £2,143 million relating to the gas distribution licence.

Pensions

The Group operates pension arrangements for employees many of whom are members of Section C of the defined benefits section of the National Grid UK Pension Scheme (NGUKPS) which is closed to new entrants. Membership of the defined contribution scheme is offered to all new employees.

With respect to the DB pension arrangements the Group made contributions of £75 million (2018: £60 million) during the course of the year including £39 million (2018: £38 million) as part of a deficit reduction plan agreed with the trustees.

On an IAS 19 basis the defined benefits pension scheme is in a net asset position of £690 million at 31 March 2019 (2018: £507 million) due to actuarial gains and higher returns on plan assets than the discount rate.

A pre-tax exceptional expense of £14m has been recorded in the year ended 31 March 2019 as a past service cost in respect of the equalisation of guaranteed minimum pension ("GMP") benefits. On 26 October 2018, the High Court handed down a judgement involving Lloyds Banking Group defined benefit pension schemes. The judgement concluded that the schemes should equalise pension benefits for men and women in relation to GMP benefits.

Impact of new accounting standards – IFRS 9, 15 and 16

Three new accounting standards are being introduced, two of which came into effect on 1 April 2018 (IFRS 9 and IFRS 15), with the third, IFRS 16, coming into effect on 1 April 2019 for the Group.

IFRS 9 'Financial Instruments' addresses accounting for our financial assets and financial liabilities. As part of this, it introduces new rules for hedge accounting and a new impairment model for financial assets. An adjustment on transition of £6m was made to other non-current assets relating to a loan to a counterparty that was deemed as impaired under the expected loss model. This has been recognised through retained earnings in line with the standard. The Group is now showing cost of hedging in a separate reserve as required under the new standard, and will also be conducting effectiveness tests in a different way, which we anticipate will lead to reduced ineffectiveness. The Group has also taken this opportunity to revise its policies to designate the derivatives, including credit, which will lead to reduced P&L volatility. On transition, as a result of the impairment and changes to hedging outlined above, there is a £7m decrease in retained earnings and a £1m increase in the cost of hedging reserve. IFRS 15 'Revenue from Contracts with Customers' is based on the principle that revenue is recognised when control of a good or service transfers to a customer.

Impact of new accounting standards – IFRS 9, 15 and 16 (continued)
The impacts on the Group's results for the period are a cumulative adjustment to increase equity at 1 April 2018 by £14m and an increase in revenue of £55m for the twelve months ended 31 March 2019. This reflects a change to customer contributions received towards altering, diverting or relocating a tangible fixed asset. Comparative values have not been restated.

IFRS 16 'Leases' will primarily affect the accounting for the Group's operating leases and will result in an increase in the number of leases being recognised on the balance sheet as the distinction between operating and finance leases is removed. The Group expects to recognise right-of-use assets of approximately £26m on 1 April 2019 and lease liabilities of £23m (after adjustments for prepayments recognised as at 31 March 2019). Overall net assets will be approximately £3m higher, and net current liabilities will be £6m higher due to the presentation of a portion of the liability as a current liability. In addition to this, the Group will continue to recognise finance leases with lease liability and asset carrying value of £6m.

Performance summary

We believe that transparent disclosure of performance against our targets is essential. The KPIs reported are reviewed regularly by the Group's Executive Committee and the Safety, Health, Environment and Security (SHES) Committee, who are accountable for environmental policy and performance. Some of our measures have been imposed by our regulator and are marked accordingly.

Risk & Compliance Process Overview

The Board is committed to protecting and developing our reputation and business interests. It has overall responsibility for risk management within the business. It has set the risk appetite for the Group and reviews the risk profile at least annually.

We have adopted a risk management model which places responsibility for actively managing risks firmly with the business. There is a central team who set the risk management framework, facilitate reporting, provide advice and challenge to the business.

Executive Committee members regularly review their risks to assess their current status, progress of mitigation plans and to identify emerging or developing risks. The Executive Committee reviews the Group's risk profile on a regular basis bringing together top down and bottom up risk management. The Group are always seeking better ways to deliver our risk management process. The Audit and Risk Committee reviews the effectiveness of the overall risk management policy and process on an annual basis.

In addition to the risk management process there are a number of assurance processes operated by specialist teams embedded within the business. These teams provide assurance over the effectiveness of the financial and non-financial internal controls operating across the business.

The Board places the responsibility for monitoring the effectiveness of the risk management process and internal controls through the Audit and Risk Committee's annual review and regular compliance reports. This includes compliance with our licence conditions which is recognised as a principal risk.

<u>Financial risk management</u>
The management of the Group and the execution of the Group's strategy are subject to a number of financial risks. The Directors have identified the need to manage the Group's material financial risks, including liquidity, credit, interest rate and market risks (including foreign currency risks). These risks are monitored through a Group Treasury management function ("Treasury") which invests surplus funds, mitigates foreign exchange exposure and manages borrowings for Quadgas MidCo Limited and its subsidiaries.

Treasury also seeks to limit third party counterparty risk which arises from the investment of surplus funds and the use of derivative financial instruments. Treasury monitors the exposure that the Group has with any one counterparty against agreed limits and these limits are monitored regularly and updated for changes in credit ratings.

Liquidity risk

Liquidity risk is the risk that the Group will not have sufficient funds to meet the obligations or commitments resulting from its business operations or associated with its financial instruments, as they fall due. The Group manages the liquidity profile of its assets, liabilities and commitments so that cash flows are appropriately balanced and all funding obligations are met when due. This is achieved through maintaining a prudent level of liquid assets, and arranging funding facilities.

The Board is responsible for monitoring the policies, setting the limits on the maturity of liquidity and deposit funding balances and taking any action as appropriate.

Credit risk

The Group takes on exposure to credit risk, which is the risk that financial loss arises from the failure of a customer or counterparty to meet its obligations under a contract as they fall due. Credit risk arises principally from trade finance and treasury activities. The Group has dedicated standards, policies and procedures to control and monitor credit risk. The counterparties under treasury activities consist of financial institutions. In accordance with IFRS 9, the Directors have considered and quantified the exposure of the Group to counterparty credit risk and have made adjustments for loss allowance as required under the expected loss model. The exposure to counterparty credit risk will continue to be monitored. Although the Group is potentially exposed to credit loss in the event of non-performance by counterparties, such credit risk is controlled through regular credit rating reviews of the counterparties and by limiting the total amount of exposure to any one party. Management does not anticipate any counterparty will fail to meet its obligations.

Significant changes in the economy or in the utilities sector could result in losses not necessarily provided for at the Statement of Financial Position date. There are only forty principal customers. The credit worthiness of each of these is closely monitored. Whilst the loss of one of the principal customers could have a significant impact on the Group, due to the small number of these, the exposure to such credit losses would be mitigated in most cases by the protection the regulator provides to cover such losses. Nonetheless, the credit management process must be closely adhered to, to avoid such circumstances, and the Group's management therefore closely monitor adherence to this process.

Market risk

Market risk is the risk that future cash flows of a financial instrument, or the fair value of a financial instrument, will fluctuate because of changes in market prices. Market prices include foreign exchange rates, interest rates, inflation, equity and commodity prices. The main types of market risk to which the Group is exposed are interest rate risk, inflation risk and exchange risk in relation to debt issued in foreign currency. The Board is required to review and approve policies for managing these risks on an annual basis. The Board approves all new hedging instruments entered into. The management of market risk is undertaken by reference to risk limits, approved by the Chief Financial Officer or Head of Treasury under delegated authority from the Board.

The Group has no significant transactional foreign exchange, equity or commodity exposure. The Group has exposure to interest rate risk and inflation risk and this is explained in the sections below. The Group borrows in the major global debt markets at fixed, index-linked and floating rates of interest, using derivatives, where appropriate, to generate the desired effective interest basis.

The company has limited direct exposure to the impacts of Brexit, however we recognise the potential macroeconomic impacts which are addressed through our financial risk management.

We have mitigated the short-term risk of supply chain disruptions by engaging with our suppliers to understand their Brexit plans and closely monitoring their delivery performance. We have also taken a prudent approach and increased our stock levels to preserve the delivery of operational activities. Other risks will continue to be reviewed as more information becomes available about the final outcome and the impact that it could have for us in the long term, but analysis carried out to date did not reveal a wider material risk in relation to Brexit for our business.

Interest rate risk
Interest rate risk is the risk that either future cash flows of a financial instrument, or the fair value of a financial instrument, will fluctuate because of changes in market interest rates. The Group's floating rate borrowings and derivatives are exposed to a risk of change in cash flows due to changes in interest rates. The Group's fixed rate borrowings and derivatives are exposed to a risk of change in their fair value due to changes in interest rates.

Our principal risks and uncertainties include:

1. **Health, safety and environment**

   Safety will always be a top priority and whilst major incidents are rare, human factors, asset and system malfunctions carry an inherent risk to our staff and the communities we serve. A major incident could cause disruption for our customers and loss of credibility with regulators. It could also result in damage to our reputation and significant financial penalties or claims.

   Risk management:
   - We have a robust safety and environmental management systems in place which are underpinned by a Health & Safety Executive accepted safety case.
   - There is visible leadership and commitment to health, safety and environmental matters, including regular leadership safety visits which has created a strong safety culture throughout the organisation.
   - We operate process safety controls which are supported by robust incident investigation and review processes.
   - We have long term, risk based investment and replacement programmes to ensure that we maintain a safe and efficient network.
   - In the event of an incident we have well practiced crisis management response procedures in place.
   - To support continual improvement across the industry there are structures in place for cross-industry sharing of good practice and learning.

2. **Failure to effectively manage assets and maintain network reliability**

   To ensure that we efficiently maintain a safe and reliable network for our customers, we must implement an effective asset management framework. It must, through appropriate policies and procedures, good quality asset data, suitable investment and competent personnel, deliver an effective process for preserving the integrity of both individual assets and the operation of our networks as a whole to deliver the right service to our customers and stakeholders. Failure to effectively manage risk on individual assets or on our networks could lead to asset failures which may result in customer service failures, a safety or environmental incident or failure to meet our regulatory standards of service. This could damage our reputation and may lead to additional costs, enforcement action or financial penalties.

   Risk management:
   - We have an asset management framework in place that is independently accredited to ISO55001 standard.
   - We have engineering and asset management teams in place to manage the framework and ensure good quality asset decisions and investments are made.
   - The framework is supported by decision support tools to aid complex decision making and ensure resilience is maintained.
   - Engineering policies and procedures are in place to ensure that assets are appropriately operated and maintained.
   - A replacement programme is in place and agreed with our regulators to ensure that ageing assets are replaced.
   - In the event of asset failure, insurance is in place to compensate for damage arising.

3. **Cyber breach or critical system failure**

   Due to the nature of our business, we rely on technological systems to support our operational procedures. We recognise, that our critical national infrastructure (CNI) systems, may be a potential target for cyber threats. We must protect our business assets and infrastructure and be prepared for a malicious attack. To ensure that we efficiently maintain a safe and reliable network for our customers, we implement an effective asset management framework. It must, through appropriate policies and procedures, good quality asset data, suitable investment and competent personnel, preserve the integrity of both individual assets and the operation of our networks as a whole.

Risk management:

- Critical processes and systems are understood and security controls designed on a risk based approach.
- Cyber controls are currently provided under an arm's length agreement from National Grid's Digital Risk and Security team which is scheduled to finish by the end of March 2020.
- We use industry best practices as part of our cyber security policies, processes and technologies. Our cyber security programme is a global programme of work which started in 2010 and continues to be modified and updated to this day. This programme is intended to reduce the risk that a cyber threat could adversely affect the Group's business resilience.
- We continually invest in cyber strategies that are commensurate with the changing nature of the security landscape. This includes collaborative working with Business, Energy and Industrial Strategy (BEIS) and the Centre for Protection of National Infrastructure on key cyber risks and development of an enhanced CNI security strategy.
- Business Continuity Management (BCM) and resilience steering Groups are in place to ensure the effective management of BCM and resilience across our business.
- BCM plans are in place for critical processes and routinely tested.
- Our Digital Risk and Security team have been engaging with the appropriate agencies to ensure we have appropriate controls in place to manage our obligations under the Network Information Security Regulations which all providers of critical national infrastructure must comply with.

4. Failure to comply with legal and regulatory requirements or failure to deliver regulatory outputs

As a regulated business, compliance with legislative and regulatory requirements is fundamental to our ability to operate. Failure to comply with legal and regulatory requirements could indicate failures in delivering an adequate service to our customers. It could also result in disruption to the operational business, financial penalties and damage our reputation. Failure to deliver regulatory outputs would damage our credibility with the regulator and customers. It could also impact our ability to earn future returns.

Risk management:

- We have structured our business around the delivery of our regulatory outputs. Dedicated operational teams are in place to focus on the delivery of our standards of service, delivery of our mains replacement programme and upgrading our network assets.
- Detailed outputs were set at the beginning of the RIIO price control and these are carefully monitored through a governance framework which includes weekly issues calls and monthly customer performance reviews to ensure that emerging risks and issues are escalated and managed in a timely manner.
- There is a strong compliance culture. This is reflected in our values of 'courage' and 'commitment'. To sustain this culture, all employees are trained in our ethical guide, 'Always Doing the Right Thing' and suppliers are expected to sign up to our supplier code of conduct. This is also supported by a strong 'tone from the top' and internal communication programme.
- We operate a compliance process which includes the review of our compliance with legal and regulatory obligations and is reported through the organisation to our Audit and Risk Committee and Board.
- We have a horizon scanning forum to identify, and ensure we prepare, for regulatory changes and developments.

5. Failure to secure critical skills and engagement

The people who work for us are essential to the success of our business. Both our direct workforce and those engaged through our partners and supply chain must be resilient and capable of adapting to the needs of the industry. The aging profile of our workforce and competition for limited skilled resources in our supply chain means this is a key risk that we must manage. Our people are essential to delivering our future vision. Without the right balance of skills our operational performance, customer service and ability to adapt to the future needs of the industry will be adversely affected.

Risk management:

- The aging workforce and ability to secure enough skilled workers is a risk for our industry. We are pursuing both internal and industry wide approaches to mitigate this risk. Strategic workforce planning helps us understand our future resourcing needs, including those operationally critical roles to evaluate the best mitigation strategies.
- Succession plans are in place for operationally critical roles.
- To build our internal resource pool and develop our future pipeline of talent, we have developed a series of entry talent programmes, including those for graduates and apprentices and have training programmes and facilities in place to ensure the skills we need are developed.
- To attract and retain the right people, our reward packages are competitively benchmarked and incentivise performance aligned to the performance of the Group's objectives.
- To ensure that employees remain engaged we undertake regular monitoring of employee engagement which allows us to identify and address any areas of concern.
- As this is an industry wide issue we also support development of the Science, Technology, Engineering and Mathematics (STEM) subjects through associated bodies such as the Energy Networks Association (ENA).
- We work closely with our Strategic Partners to monitor the availability of skilled teams to undertake our mains replacement work and have targeted recruitment programmes.

6. Disruptive forces and regulatory responses

The gas industry is evolving and we must respond. Comparative regulation is increasingly driving network operators to deliver greater efficiencies against increasing expectations from customers. In addition, the UK has to deliver stretching climate change targets which will require significant decarbonisation of energy heat and transport. Hence this makes innovation essential to our continued success to deliver for current and future customers.

As a regulated business our future opportunities are directly affected by factors driving the landscape of the energy industry. These include emergent technologies, political events, changes in consumer habits and social trends, media coverage, public opinion and government views, which are reflected in the decisions of policy makers and regulators to define the way in which we run our business.

Risk management:

- We will maintain credibility for delivery through the careful management of our current regulatory obligations and workload. There is a dedicated process improvement team to facilitate the implementation of change plans where improvement is needed, and a dedicated innovation team to seek ways to improve and outperform our targets.
- We monitor external developments to understand potential disruptive forces, including emerging technologies, changes in societal norms and the political consensus which may affect our business plan. These may include both negative threats, and potential new opportunities.
- We have established a Stakeholder Advisory panel to test our approach to engagement and strategy.
- We undertake regional and national Stakeholder engagement to understand policy, customer driven and regulatory landscape.

- We have established a 'Future Role of Gas' programme looking at future scenarios and considering how network needs to adapt and evolve to a decarbonised world.
- There are extensive structures in place through the Energy Networks Association, Energy Innovation Centre and with BEIS, Ofgem and the third parties to share innovations with other gas distribution networks and across utilities and third parties to ensure we are implementing best practice and coordinating our approach to solving decarbonisation.
- Involved in industry code development and market workgroups to monitor and input to industry change.

7. Failure to protect consumers' interests

We must keep both current, and future consumers, safe and warm whilst delivering good value for money. Although a small proportion of the overall bill, we are mindful of the effect that network costs have on our consumers' energy bills and are committed to improving the service levels they can expect from us.

Risk Management:

- Customer performance is recognised as a priority for our business and a dedicated 'Customer Performance' function has been established to ensure we are performing for our customers.
- We are pioneering developments in a cross industry safeguarding customers group looking at services that are provided to customers in vulnerable situations.
- We continue to invest in our networks to maintain and improve service levels.
- We have a culture of continuous improvement to drive down cost and better serve our customers.
- We have established clear customer targets which are closely monitored, with improvement plans in place where necessary. This is monitored and governed by our Customer Performance Committee.
- There is a commitment, at all levels of the organisation, to improve customer performance. This is reinforced through regular employee communications, which share good practice across the organisation.
- Strategic projects have been established to specifically tackle areas of historic poor performance, such as connections.
- Special measures in place for customers identified by the Priority Services Register and mechanisms in place to help customers register as priority customers.
- Customer Performance Committee which has been enhanced to a Customer Operations Performance Committee from April 2019.

The Strategic Report was approved by the Board and signed on its behalf by:

M W Braithwaite
Director
27 June 2019

Quadgas MidCo Limited
Directors' Report
For the year ended 31 March 2019

The Directors present their Report and the audited financial statements of the Group and the company for the year ended 31 March 2019.

Principal activities and business review

A full description of the Group's and company's principal activities, businesses, key performance indicators and principal risks and uncertainties is contained in the Strategic Report on pages 1 to 11, which are incorporated by reference into this report.

Directors

The Directors of the company during the year and up to the date of signing of the financial statements were:

M W Braithwaite	
J Korpancova	
H C Higgins	
D Karnik	
P D Noble	
D J Xie	
I M Coucher	
A M Al-Ansari	(Appointed 17 May 2018)
N J Axam	(Appointed 17 May 2018)
H Su	(Appointed 23 August 2018)
M W Mathieson	(Appointed 28 November 2018)
R Greenleaf	(Appointed 28 November 2018)
E B Fidler	(Appointed 29 November 2018)
S C Humphreys	(Appointed 20 July 2018, Resigned 29 October 2018)
S Fennell	(Appointed 15 May 2019)
A G Ray	(Resigned 16 May 2018)
A B F Al-Thani	(Resigned 17 May 2018)
A J Agg	(Resigned 20 July 2018)
J Bao	(Resigned 23 August 2018)
C J Waters	(Resigned 29 October 2018)
L N Shaw	(Resigned 29 October 2018)
C P Bennett	(Resigned 29 October 2018)
M Bradley	(Resigned 28 November 2018)
A McMenamin	(Resigned 29 November 2018)
M J Gregory	(Resigned 15 May 2019)

Future developments

Details of future developments have been included within the Strategic Report on page 1.

Dividends

Our dividend policy is to balance the distribution of available surplus funds to shareholders but after having the forward committed cash requirements of the business to support our investment programmes and importantly the managing the appropriate level of gearing. During the year we paid dividends totalling £340 million (2018: £369 million)

Political donations and political expenditure

The Group did not make any political donations or political expenditure during the current year (2018: £8,500).

Research and development

Expenditure on research and development for the Group was £6 million during the current year (2018: £8 million).

Directors' indemnity

Quadgas HoldCo Limited (the indirect parent company) has arranged, in accordance with the Companies Act 2006 and the Articles of Association, qualifying third party indemnities against financial exposure that Directors may incur in the course of their professional duties. Alongside these indemnities, Quadgas HoldCo Limited places Directors' and Officers' liability insurance for each Director.

Going concern

The company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report on pages 1 to 11. The financial position of the company, its cash flows, liquidity position and borrowing facilities are described in this Strategic Report on pages 1 to 11. In addition, note 28 to the financial statements include the company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

The company has considerable financial resources together with long-term contracts with a number of customers and suppliers across different geographic areas. As a consequence, the Directors believe that the company is well placed to manage its business risks successfully despite the current uncertain economic outlook and challenging RIIO-2 framework.

Despite the loss incurred in the year of £974 million (2018: Profit £303 million) driven by a goodwill impairment and net current liabilities position as at 31 March 2019 of £117 million (2018: £120 million), the Directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Management continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Capital structure

The capital structure of the Group consists of shareholders' equity, as disclosed in the consolidated statement of changes in equity, and net debt.

Control and Risk Management

The Group has established internal control and risk management systems in relation to the process for preparing consolidated financial statements. The key features of these internal control and risk management systems are:

- The risk assurance function and management conducts various checks on internal financial controls periodically.
- Management regularly monitors and considers developments in accounting regulations and best practice in financial reporting, and where appropriate, reflects developments in the consolidated financial statements. Appropriate briefings and/or training are provided to key finance personnel on relevant developments in accounting and financial reporting. The Audit and Risk Committee is also kept appraised of such developments.
- The financial statements are subject to review by the Financial Reporting function for unusual items, unexplained trends and completeness. Any unexplained items are investigated.
- The Financial Reporting function compares the financial statements to the management accounts received during the year and obtains explanations for any material differences.
- The Group's consolidation, which consolidates the results of each business unit and makes appropriate adjustments, is subject to various levels of review by the Financial Reporting function.

- The Audit and Risk Committee and the Board review the draft consolidated financial statements. The Audit and Risk Committee receives reports from management and the external auditor on significant judgements, changes in accounting policies, changes in accounting estimates and other pertinent matters relating to the consolidated financial statements.

Post balance sheet events

To ensure a sustainable future for our customer and business, Cadent announced on the 13 May 2019 that it was offering a voluntary redundancy programme for all managers and staff. The cost of this programme cannot be determined with certainty at this stage as the programme is subject to employee consultation with the period of consultation running to 26 June 2019. Management's current best estimate is a cost between £15m - £20m.

Disclosure of information to auditor

Having made the requisite enquiries, so far as the Directors in office at the date of the approval of this report are aware, there is no relevant audit information of which the auditor is unaware and each Director has taken all reasonable steps to make themselves aware of any relevant audit information and to establish that the auditor is aware of that information.

Auditor

A resolution to re-appoint Deloitte LLP as auditor of the company will be proposed at the Annual General Meeting for shareholder approval.

Employees

Across the Group, we communicate with our employees across a wide variety of topics and have established effective channels to do this, for example: emails, the Group intranet, cascade briefings, sms alerts, voice messages and in-house newsletters. We believe that it is important to seek the views of our employees to inform decision making on matters which may affect them, and both formal and informal mechanisms are used to ensure that regular consultation takes place with employees and their trade union representatives.

We are committed to equality, inclusion and diversity and aim to support employees in achieving and maintaining a good balance between their work and personal lives. We promote equality in the development and application of our policies, through our recruitment processes and in training and development opportunities.

It is our policy that people with disabilities are treated fairly in relation to job applications and opportunities for training, career development and promotion. When employees are unable to continue working in their current role due to disability during their employment, every effort is taken to make reasonable adjustments, provide suitable training and identify alternative roles, if required.

Read about our policies in relation to ethical conduct, gender pay, anti-corruption and bribery, modern slavery and other topics at https://cadentgas.com/about-us/corporate-governance.

Quadgas MidCo Limited
Directors' Report (continued)
For the year ended 31 March 2019

Statement of Directors' responsibilities

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

Company law requires the directors to prepare financial statements for each financial period. Under that law the directors have prepared the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and company and of the profit or loss of the Group and company for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable IFRSs as adopted by the European Union have been followed for the Group financial statements and United Kingdom Accounting Standards, comprising FRS 101, have been followed for the company financial statements, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and company and enable them to ensure that the financial statements comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The Directors are also responsible for safeguarding the assets of the Group and company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors' Report was approved by the Board and signed on its behalf by:

M W Braithwaite
Director
27 June 2019

Registered office:
Ashbrook Court, Prologis Business Park, Central Boulevard, Coventry, CV7 8PE

Registered in England and Wales
Company registration number: 10615396

Independent auditor's report to the members of Quadgas MidCo Limited

Independent auditor's report to the members of Quadgas MidCo Limited

Report on the audit of the financial statements

Opinion

In our opinion:

- the financial statements of Quadgas MidCo Limited (the 'parent company') and its subsidiaries (the 'Group') give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 March 2019 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the Consolidated Income Statement;
- the Consolidated Statement of Comprehensive Income;
- the Consolidated and parent company Statements of Financial Position;
- the Consolidated and parent company Statements of Changes in Equity;
- the Consolidated Statement of Cash flows;
- the related notes 1 to 34 in the consolidated financial statements; and
- the related notes 1 to 16 to the parent company financial statements.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 101 "Reduced Disclosure Framework".

Basis for opinion

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

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

Conclusions relating to going concern

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

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

We have nothing to report in respect of these matters.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

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

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

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

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

Report on other legal and regulatory requirements

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

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

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

Matters on which we are required to report by exception
Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

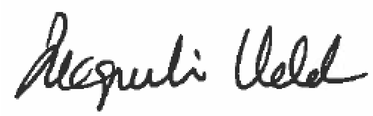
- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors'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

We have nothing to report in respect of these matters.

Independent auditor's report to the members of Quadgas MidCo Limited (continued)

Use of our report

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



Jacqueline Holden FCA (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom
27 June 2019

Quadgas MidCo Limited
Consolidated Income Statement
For the year ended 31 March 2019

	Notes	**2019 £m**	**2019 £m**	2018 £m	2018 £m
Revenue	4		**1,986**		1,852
Operating costs before exceptional items			**(1,204)**		(1,184)
Operating profit					
Before exceptional items	5	**782**		668	
Exceptional items	6	**(1,405)**		(20)	
Total operating (loss) / profit	5		**(623)**		648
Income from interests in associated undertakings			**-**		-
Finance income	9		**16**		3
Finance costs	9				
Before exceptional items and remeasurements	9	**(264)**		(272)	
Exceptional items and remeasurements	6	**(13)**		-	
Total interest payable and similar charges	9		**(277)**		(272)
(Loss)/profit before tax					
Before exceptional items and remeasurements		**534**		399	
Exceptional items and remeasurements	6	**(1,418)**		(20)	
Total (loss)/profit before tax			**(884)**		379
Tax					
Before exceptional items and remeasurements		**(98)**		(80)	
Exceptional items and remeasurements	6	**8**		4	
Total tax	10		**(90)**		(76)
(Loss)/profit after tax					
Before exceptional items and remeasurements		**436**		319	
Exceptional items and remeasurements	6	**(1,410)**		(16)	
(Loss)/profit for the year			**(974)**		303

The results reported above relate to continuing activities.

The notes on pages 24 to 80 are an integral part of the financial statements.

Quadgas MidCo Limited
Consolidated Statement of Comprehensive Income
For the year ended 31 March 2019

	2019 £m	2018 £m
(Loss)/profit for the year	**(974)**	303
Other comprehensive income		
Items that will not be reclassified to profit or loss		
Remeasurements of post-employment benefit obligations	**132**	436
Tax on remeasurements of post-employment benefit obligations	**(23)**	(75)
Total items that will never be reclassified to profit or loss	**109**	361
Items that may be reclassified subsequently to profit or loss		
Net gains/(losses) in respect of cash flow hedges	**(4)**	14
Net gains/(losses) in respect of cost of hedging reserve	**(8)**	-
Amortisation of cost of hedging reserve	**5**	-
Tax on net gains/(losses) in respect of cash flow hedges	**1**	(2)
Total items that may be reclassified subsequently to profit or loss	**(6)**	12
Other comprehensive income for the year, net of tax	**103**	373
Total comprehensive (loss)/income for the year	**(871)**	676

The value of derivatives held to hedge cash flows is impacted by changes in expected interest rates and in exchange rates. The net loss for the period was £6m (2018: £12m gain).

Quadgas MidCo Limited
Consolidated Statement of Financial Position
As at 31 March 2019

	Notes	**2019** **£m**	2018 £m
Non-current assets			
Intangible assets	13	**4,146**	5,514
Property, plant and equipment	14	**10,977**	10,614
Pension and other post-retirement benefit assets	27	**690**	507
Other non-current assets	17	**44**	50
Derivative financial assets	18	**8**	13
Total non-current assets		**15,865**	16,698
Current assets			
Inventories	16	**10**	6
Trade and other receivables	17	**219**	237
Derivative financial assets	18	**-**	5
Current asset investments	19	**339**	161
Cash and cash equivalents		**12**	20
Total current assets		**580**	429
Total assets		**16,445**	17,127
Current liabilities			
Trade and other payables	20	**(560)**	(421)
Derivative financial liabilities	18	**-**	(3)
Borrowings	22	**(66)**	(53)
Current tax liabilities		**(56)**	(55)
Provisions	23	**(15)**	(17)
Total current liabilities		**(697)**	(549)
Non-current liabilities			
Derivative financial liabilities	18	**(38)**	(9)
Borrowings	22	**(9,476)**	(9,110)
Deferred tax liabilities	10	**(1,928)**	(1,921)
Provisions	23	**(80)**	(78)
Accruals and deferred income	21	**(27)**	(58)
Total non-current liabilities		**(11,549)**	(11,176)
Total liabilities		**(12,246)**	(11,725)
Net assets		**4,199**	5,402
Equity			
Share capital	24	**1**	1
Share premium account		**-**	-
Cash flow hedge reserve		**8**	12
Cost of hedging reserve		**(1)**	-
Retained earnings		**4,191**	5,389
Total equity		**4,199**	5,402

The notes on pages 24 to 80 are an integral part of these financial statements.

The consolidated financial statements on pages 19 to 80 were authorised and approved for issue by the Board of Directors on 27 June 2019 and were signed on its behalf by:

M W Braithwaite
Director
Quadgas MidCo Limited
Company registration number: 10615396

Quadgas MidCo Limited
Consolidated Statement of Changes in Equity
For the year ended 31 March 2019

	Share capital £m	**Share premium account £m**	**Cash flow hedge reserve £m**	**Cost of Hedging Reserve £m**	**Retained earnings £m**	**Total £m**
At 1 April 2018	**1**	**-**	**12**	**-**	**5,389**	**5,402**
Changes due to adoption of IFRS 15 & IFRS 9	**-**	**-**	**-**	**1**	**7**	**8**
At 1 April 2018 (restated)	**1**	**-**	**12**	**1**	**5,396**	**5,410**
Loss for the year	**-**	**-**	**-**	**-**	**(974)**	**(974)**
Other comprehensive income/ (loss) excluding amortisation of cost of hedging reserve	**-**	**-**	**(4)**	**(7)**	**109**	**98**
Amortisation of cost of hedging reserve	**-**	**-**	**-**	**5**	**-**	**5**
Total comprehensive income/(loss) for the year	**-**	**-**	**(4)**	**(2)**	**(865)**	**(871)**
Equity dividends	**-**	**-**	**-**	**-**	**(340)**	**(340)**
At 31 March 2019	**1**	**-**	**8**	**(1)**	**4,191**	**4,199**

	Share capital £m	Share premium account £m	Cash flow hedge reserve £m	Cost of Hedging Reserve £m	Retained earnings £m	Total £m
At 1 April 2017	4,928	-	-	-	(10)	4,918
Profit for the year	-	-	-	-	303	303
Other comprehensive income/ (loss) for the year	-	-	12	-	361	373
Total comprehensive income for the year	-	-	12	-	664	676
New shares issued	177	-	-	-	-	177
Share capital reduction	(5,104)	-	-	-	5,104	-
Equity dividends	-	-	-	-	(369)	(369)
At 31 March 2018	1	-	12	-	5,389	5,402

The cash flow hedge reserve in relation to the cross-currency interest rate swap contracts will be recycled to the income statement over the life of the hedged items.

Quadgas MidCo Limited
Consolidated Statement of Cashflows
For the year ended 31 March 2019

	2019 £m	2018 £m
Cash flows from operating activities		
Total operating (loss)/profit	**(623)**	648
Adjustments for:		
Exceptional items	**1,405**	20
Depreciation, amortisation and impairment	**369**	354
(Increase)/decrease in inventories	**(4)**	1
Decrease/(increase) in trade and other receivables	**9**	(26)
Increase in trade and other payables	**13**	41
Capital contribution income	**(55)**	-
Changes in provisions	**-**	(1)
Gain on disposal of property, plant and equipment	**(1)**	(1)
Changes in pensions and other post-retirement obligations	**(53)**	(32)
Cashflows relating to exceptional items	**(14)**	(18)
Cash generated from operations	**1,046**	986
Tax paid	**(104)**	(116)
Net cash from operating activities	**942**	870
Cash flows from investing activities		
Purchases of intangible assets	**(22)**	(3)
Purchases of property, plant and equipment	**(645)**	(577)
Capital contributions	**91**	59
Disposals of property, plant and equipment	**2**	1
Interest received	**1**	-
Net increase in financial investments	**(178)**	(102)
Net cash used in investing activities	**(751)**	(622)
Cash flows from financing activities		
Proceeds received from loans	**1,391**	1,018
Repayment of loans	**(1,046)**	(673)
Repayment of obligations under finance leases	**(1)**	-
Interest paid	**(207)**	(194)
Dividends paid to shareholders	**(340)**	(369)
Net cash used in financing activities	**(203)**	(218)
Net increase/(decrease) in cash and cash equivalents	**(12)**	30
Cash and cash equivalents/(overdraft) at beginning of period	**15**	(15)
Cash acquired	**-**	-
Net cash and cash equivalents/(overdraft) at end of period	**3**	15
Comprising - Cash	12	20
- Overdraft	(9)	(5)

1 Summary of significant accounting policies

Quadgas MidCo Limited is a private company limited by shares and is incorporated and domiciled in the United Kingdom and is registered in England and Wales. The address of its registered office is Ashbrook Court, Prologis Business Park, Central Boulevard, Coventry, CV7 8PE, UK.

The principal accounting policies applied in the preparation of these consolidated financial statements are set out as below. These policies have been consistently applied to the current period presented, unless otherwise stated.

(a) Basis of preparation

The financial statements for the Group have been prepared on the going concern basis (see Directors' report on page 13) under the historical cost convention modified to include certain items at fair value.

Items included in the financial statements are measured using the currency of the primary economic environment in which the company operates (the 'functional currency'). The financial statements are presented in pounds sterling which is also the company's functional currency.

(i) Consolidated financial statements

The consolidated financial statements of Quadgas MidCo Limited have been prepared in accordance with International Financial Reporting Standards (IFRS), International Accounting Standards (IAS), IFRIC interpretations issues and effective and ratified by the European Union as at 31 March 2019 and the Companies Act 2006.

(b) Basis of consolidation

The consolidated financial statements include the results of Quadgas MidCo Limited and its subsidiaries and associate undertakings. Results are included from the date of acquisition or incorporation and excluded from the date of disposal.

Subsidiaries are consolidated where the Group has the power to control a subsidiary.

Associates are accounted for on an equity basis where the Group holding is 20% or more and the Group has the power to exercise significant influence.

Acquisitions are accounted for using the acquisition method, where the purchase price is allocated to the identifiable assets acquired and liabilities assumed on a fair value basis and the remainder recognised as goodwill.

(c) New IFRS accounting standards and interpretations

The Group has applied IFRS 9 'Financial Instruments' and IFRS 15 'Revenue from Contracts with Customers' for the first time during the period coming into effect on 1 April 2018. The nature and effect of these changes are disclosed below.

<u>IFRS 9 'Financial Instruments'</u>

The Group adopted IFRS 9 from 1 April 2018. In accordance with the transition provisions in the standard, comparatives have not been restated.

Classification of financial assets
IFRS 9 introduces new requirements for the classification and measurement of financial assets and financial liabilities, impairment of financial assets, and rules for hedge accounting. Details for these new these new requirements as well as their impact on the financial statements are described below.

1 Summary of significant accounting policies (continued)

(c) New IFRS accounting standards and interpretations (continued)

IFRS 9 requires the use of two criteria to determine the classification of financial assets: the entity's business model for the financial assets and the contractual cash flow characteristics of the financial assets. The standard goes on to identify three categories of financial assets - amortised cost; fair value through profit or loss (FVTPL); and fair value through other comprehensive income (FVOCI).

A summary of all reclassifications, which have resulted in no change to the carrying value of any financial instrument, is shown below. All other financial instruments (cash and deposits, trade receivables, borrowings, derivative instruments etc.) measurement categories and carrying amounts remain the same.

Type of financial instrument	IAS 39 measurement category	IFRS measurement category	IAS 39 carrying amount 31 March 2018 £m	Adjustments relating to IFRS 9 transition £m	IFRS 9 carrying amount 31 March 2018 £m
Financial & other investments	Amortised cost	FVTPL	161	-	161

Financial & other investments relate to AAA rated money market funds that are repayable on demand. Due to the credit worthiness and short term nature of these investments the amortised cost amount is materially the same as the fair value.

Impairment

IFRS 9 mandates the use of an expected credit loss model to calculate impairment losses rather than an incurred loss model. Under IFRS 9 it is not necessary for a credit event to have occurred before credit losses are recognised. The new impairment model applies to the Group's financial assets and loan commitments.

The introduction of new impairment model has an impact on the Group's trade receivables measured at amortised cost. For trade receivables, the Group applies a simplified model of recognising lifetime expected credit losses as these items do not have a significant financing component. Based on the assessment undertaken, there is an immaterial difference between IFRS 9 and IAS 39 hence no transition adjustment has been recorded.

An adjustment on transition of £6m was made to other non-current assets relating to a loan to a counterparty that was deemed as impaired under the expected loss model. This has been recognised through retained earnings in line with the standard.

Hedge accounting

IFRS 9 contains new requirements on the application of hedge accounting. The new requirements look to align hedge accounting more closely with entities' risk management activities by increasing the eligibility of both hedged items and hedging instruments and introducing a more principles-based approach to assessing hedge effectiveness.

IFRS 9 introduces an optional treatment for cross currency swaps designated in hedge relationships, whereby the currency basis element can be bifurcated with changes in fair value recorded in other comprehensive income ("OCI"). The Group has elected to apply this accounting treatment.

There is no impact on the Group's accounting for financial liabilities, as the new requirements only affect the accounting for financial liabilities that are designated at fair value through profit and loss and the Group does not have any such liabilities. The derecognition rules have been transferred from IAS 39 and have not been changed.

1 Summary of significant accounting policies (continued)

(c) New IFRS accounting standards and interpretations (continued)

On transition, as a result of the impairment and changes to hedging outlined above, there is a £7m decrease in retained earnings and a £1m increase in the cost of hedging reserve.

In summary, the following adjustments were made to the amounts recognised in the statement of financial position at the date of initial application (1 April 2018):

	IAS 39 carrying amount 31 March 2018* £m	Adjustments relating to IFRS 9 transition £m	IFRS 9 carrying amount 1 April 2018* £m
Retained earnings	5,389	(7)	5,382
Cash flow hedge reserve	12	-	12
Cost of hedging reserve	-	1	1
Other non-current assets	237	(6)	231

* The amounts in this column are before the adjustments from the adoption of IFRS 15.

IFRS 15 'Revenue from Contracts with Customers'

On 1 April 2018 the Group adopted IFRS 15, applying the modified retrospective approach. IFRS 15 provides a single, principles-based approach to the recognition of revenue from contracts with customers, focussing on the identification of performance obligations in a contract and requiring revenue to be recognised when or as those performance obligations are satisfied. The impacts on the Group's results for the period are a cumulative adjustment to increase equity at 1 April 2018 by £14m, reduce accruals and deferred income by £15m, increase deferred tax by £1m and an increase in revenue of £55m for the twelve months ended 31 March 2019. This reflects a change to customer contributions received towards altering, diverting or relocating a tangible fixed asset. These customer contributions were included as deferred income and credited on a straight-line basis to the income statement over the estimated useful economic lives of the assets to which they related. Under IFRS 15, the revenue recognition has been revised with the income recognised once the performance obligation (altering, diverting or relocating a tangible fixed asset) has been completed. There is no change to the accounting for customer contributions received for connections which continues to be recognised when the connection has been completed and the performance obligation satisfied. There were no other material changes.

In summary, the following adjustments were made to the amounts recognised in the statement of financial position at the date of initial application (1 April 2018):

	IAS 18 carrying amount 31 March 2018* £m	Adjustments to customer contributions (altering, diverting or relocating a tangible fixed asset) £m	IFRS 15 carrying amount 1 April 2018* £m
Accruals and deferred income (non-current)	(58)	40	(18)
Accruals and deferred income (current)	(133)	(25)	(158)
Deferred tax	(1,921)	(1)	(1,922)
Retained earnings	5,389	14	5,403

* The amounts in this column are before the adjustments from the adoption of IFRS 9.

1 Summary of significant accounting policies (continued)

(c) New IFRS accounting standards and interpretations (continued)

New accounting standards not yet applied

IFRS 16 was issued in January 2016. It has resulted in almost all leases being recognised on the balance sheet by lessees, as the distinction between operating and finance leases is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognised. The only exceptions are short-term and low-value leases.

The Group will apply the standard from its mandatory adoption date of 1 April 2019. The Group intends to apply the simplified transition approach and will not restate comparative amounts for the year prior to first adoption. Right-of-use assets for property leases will be measured on transition as if the new rules had always been applied. All other right-of-use assets will be measured at the amount of the lease liability on adoption (adjusted for any prepaid or accrued lease expenses).

The Group have reviewed all of the Group's leasing arrangements over the last year in light of the new lease accounting rules in IFRS 16. The standard will affect primarily the accounting for the Group's operating leases.

As at the reporting date, the Group has non-cancellable operating lease commitments of £27m, see note 26. Of these commitments, approximately £1m relate to short-term leases and £0.1m to low value leases which will both be recognised on a straight-line basis as expense in profit or loss.

For the remaining lease commitments, the Group expects to recognise right-of-use assets of approximately £26m on 1 April 2019, lease liabilities of £23m (after adjustments for prepayments recognised as at 31 March 2019). Overall net assets will be approximately £3m higher, and net current liabilities will be £6m higher due to the presentation of a portion of the liability as a current liability. In addition to this, the Group will continue to recognise finance leases with lease liability and asset carrying value of £6m.

The Group expects that net profit after tax will decrease by approximately £1m for FY20 as a result of adopting the new rules. Adjusted EBITDA used to measure segment results is expected to increase by approximately £7m, as the operating lease payments were included in EBITDA, but the amortisation of the right-of-use assets and interest on the lease liability are excluded from this measure.

Operating cash flows will increase and financing cash flows decrease by approximately £6m as repayment of the principal portion of the lease liabilities will be classified as cash flows from financing activities.

The Group's activities as a lessor are not material and hence the Group does not expect any significant impact on the financial statements. However, some additional disclosures will be required from next year.

Other

Other standards and interpretations or amendments thereto which have been issued and are not yet effective are not expected to have a material impact on the company's consolidated financial statements.

- Annual improvements to IFRSs 2015–2017 Cycle; and
- Amendments to IAS 19 'Employee Benefits.

1 Summary of significant accounting policies (continued)

(d) Intangible assets

Intangible assets relate to software, which is written down (amortised) over the period we expect to receive a benefit from the asset, goodwill, which represents the excess of what was paid to acquire businesses over the fair value of their net assets at the acquisition date and the gas distribution licences, which allows the operation of the four gas distribution networks.

Identifiable intangible assets are recorded at cost less accumulated amortisation and any provision for impairment. Intangible assets, other than goodwill and those assets with indefinite useful lives, are tested for impairment only if there is some indication that the carrying value of the assets may have been impaired.

Goodwill is recognised as an asset and is not amortised as it has been deemed that it has an indefinite life, but is tested for impairment annually or more frequently if events or changes in circumstances indicate a potential impairment. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

Impairment of assets are calculated as the difference between the carrying value of the asset and the recoverable amount, if lower. Where such an asset does not generate cash flows that are independent from other assets, the recoverable amount of the cash generating unit to which that asset belongs is estimated. Impairments are recognised in the income statement and are disclosed separately. Any assets which suffered impairment in a previous period are reviewed for possible reversal of the impairment at each reporting date.

Internally generated intangible assets, such as software, are recognised only if an asset is created that can be identified; the technical feasibility of completing the intangible asset so that it will be available for use; the intention to complete the intangible asset and use it; the ability to use the intangible asset; it is probable that the asset will generate future economic benefits; the availability of adequate technical, financial and other resources to complete the development and to use the intangible asset; and that the development cost of the asset can be measured reliably. Where no internally generated intangible asset can be recognised, development expenditure is recorded as an expense in the period in which it is incurred.

Subsequent to initial recognition, internally-generated intangible assets are reported at cost less accumulated amortisation and accumulated impairment losses, on the same basis as intangible assets that are acquired separately.

Intangible assets acquired in a business combination and recognised separately from goodwill are initially recognised at their fair value at the acquisition date (which is regarded as their cost). Subsequent to initial recognition, intangible assets acquired in a business combination are reported at cost less accumulated amortisation and accumulated impairment losses, on the same basis as intangible assets that are acquired separately.

Ofgem provide the business with an exclusive right to operate, invest in the infrastructure and earn a fair return on that invested capital over a 25-year daily renewing basis governed by a comprehensive regulatory framework. On the basis that the Licence gives the owner the right to operate and invest in the gas distribution networks within the licenced geographic area, the Licence has been separately recognised and valued as part of the purchase price allocation (see note 12). An indefinite useful economic life has been assumed for the Licence due to the daily renewing basis.

Intangible assets under development are not amortised. Other non-current intangible assets relate to software and are amortised on a straight-line basis over their estimated useful economic lives. The amortisation period for software is up to 8 years.

An intangible asset is derecognised on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognised in profit or loss when the asset is derecognised.

1 Summary of significant accounting policies (continued)

(d) Intangible assets (continued)

The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets with indefinite useful lives that are acquired separately are carried at cost less accumulated impairment losses.

(e) Property, plant and equipment and depreciation

The cost of these assets primarily represents the amount initially paid for them. A depreciation expense is charged to the income statement to reflect annual wear and tear and reduced value of asset over time. Depreciation is calculated by estimating the number of years we expect the asset to be used (useful economical life) and charging the cost of the asset to the income statement equally over this period.

We operate a gas distribution business and therefore have a significant physical asset base. We continue to invest in our networks to maintain reliability, create new customer connections and ensure our networks are flexible and resilient. Our business plan envisages these additional investments will be funded through a mixture of cash generated from operations and the issue of new debt.

Property, plant and equipment assets are recorded at cost, less accumulated depreciation and impairment losses.

Cost includes the purchase price of the asset, any payroll and finance costs incurred which are directly attributable to the construction of property, plant and equipment assets, as well as the cost of any associated asset retirement obligations.

Property, plant and equipment assets includes assets which the Group's interest comprises legally protected statutory or contractual rights of use. Additions represent the purchase or construction of new assets, including capital expenditure for safety and environmental assets, and extensions to, enhancements to, or replacement of existing assets.

Contributions received towards the cost of altering, diverting or relocating a tangible fixed asset are included in trade and other payables as deferred income and credited to revenue once the alteration, diversion or relocation has been completed.

Contributions received towards the cost of tangible assets from customers for connections to the gas distribution networks are initially recognised as deferred income and credited to revenue once the connection has been completed.

No depreciation is provided on freehold land or assets in the course of construction. Other items of property, plant and equipment are depreciated, on a straight line basis, at rates estimated to write off their book values over their estimated useful economic lives. In assessing the estimated useful economic lives, consideration is given to any contractual arrangements and operational requirements relating to particular assets. The assessment of estimated useful lives and residual values of assets are performed annually. Unless otherwise determined by operational requirements, the depreciation periods for the principal categories of property, plant and equipment are, in general, as shown in the table below:

Depreciation periods	**Years**
Freehold and leasehold buildings	Up to 50
Plant and Machinery	30 to 50
Motor vehicles and other equipment	Up to 10

1 Summary of significant accounting policies (continued)

(f) Fixed asset investments

Investments in subsidiaries and associated companies are carried at cost, less any provisions for impairment.

(g) Impairment of fixed assets

Impairment reviews are carried out if there is some indication that impairment may have occurred, or where otherwise required to ensure that fixed assets are not carried above their estimated recoverable amounts. Impairments are recognised in the income statement, and, where material, are disclosed as exceptional. Impairment reversals are recognised when, in management's opinion, the reversal is permanent.

Impairments of fixed assets are calculated as the difference between the carrying value of the net assets of income generating units, including where appropriate, investments, and their recoverable amounts. Recoverable amount is defined as the higher of net realisable value or estimated value in use at the date the impairment review is undertaken. Net realisable value represents the amount that can be generated through the sale of assets. Value in use represents the present value of expected future cash flows discounted on a pre-tax basis, using the estimated cost of capital of the income generating unit.

(h) Financial instruments

Initial recognition
Financial assets, liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

Classification and measurement

Financial instruments are classified at inception into one of the following categories which then determines the subsequent measurement methodology:

Financial assets are classified into one of the following three categories:

- financial assets at amortised cost; and
- financial assets at fair value through other comprehensive income (FVTOCI); and
- financial assets at fair value through profit or loss (FVTPL).

Financial liabilities are classified into one of the following two categories

- financial liabilities at amortised cost; and
- financial liabilities at fair value through profit and loss (FVTPL).

Loans receivable are carried at amortised cost using the effective interest method less any allowance for estimated impairments. A provision is established for impairments when there is objective evidence that the Group will not be able to collect all amounts due under the original terms of the loan. Interest income, together with losses when the loans are impaired, is recognised using the effective interest method in the income statement.

1 Summary of significant accounting policies (continued)

(h) Financial instruments (continued)

Borrowings, which include interest-bearing loans, are recorded at their initial fair value which normally reflects the proceeds received, net of direct issue costs less any repayments. Subsequently these are stated at amortised cost, using the effective interest method. Any difference between proceeds and the redemption value is recognised over the term of the borrowing in the income statement using the effective interest method.

Accretion on inflation linked borrowings is accounted for on an accrual basis to the income statement, and are added to the carrying value of the debt instrument to the extent that they are not settled in the period in which they arise.

Derivative financial instruments ('derivatives') are recorded at fair value. Where the fair value of a derivative is positive, it is carried as a derivative asset and where negative, as a liability.

Assets and liabilities on different transactions are only netted if the transactions are with the same counterparty, a legal right of set off exists and the cash flows are intended to be settled on a net basis. Gains and losses arising from changes in fair value are included in the income statement in the period they arise, unless hedge accounting applies.

The fair value of financial derivatives is calculated by discounting all future cash flows by the market yield curve at the reporting date and adjusting for own and counterparty credit. The market yield curve for each currency is obtained from external sources for interest and foreign exchange rates.

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

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

Derecognition

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income and accumulated in equity is recognised in profit or loss.

1 Summary of significant accounting policies (continued)

(h) Financial instruments (continued)

Impairment of financial assets

Financial assets are impaired by calculating the probability of default and the estimated recoverable amount given default, which is used to calculate the expected credit loss. The Group has taken default to be defined as a counterparty that has entered administration.

The Group recognises loss allowances for expected credit losses (ECL) on financial instruments that are not measured at FVTPL, namely:

- trade receivables; and
- loan receivables; and
- other receivables.

The Group measures the loss allowances at an amount equal to the expected credit loss. The way this is calculated is based on the applied impairment methodology, as described below:

Stage 1: For financial assets where there has not been a significant increase in credit risk since initial recognition, and were not credit impaired on recognition, the Group recognises a loss allowance based on the 12 month expected credit loss.

Stage 2: For financial assets where there has been a significant increase in credit risk since initial recognition, and were not credit impaired, the Group recognises a loss allowance for lifetime expected credit loss.

Stage 3: For financial assets which are credit impaired, the Group recognises the lifetime expected credit loss.

A significant increase in credit risk would be as a result of any change in circumstances specific to the counterparty or to the wider economic environment whereby the risk of default could be said to have been significantly increased within reasonable thresholds.

Evidence that the financial asset is credit impaired includes the following:

- significant financial difficulties of the counterparty; or
- a breach of contract such as default or past due event; or
- the restructuring of the loan or advance by the Group that the Group would not consider otherwise; or
- it is probable that the counterparty will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for an associated security because of financial difficulties.

(i) Trade receivables and accrued income

Trade receivables are amounts due from customers for goods sold or services performed in the ordinary course of business. Accrued income is amounts due from customers for goods sold or services performed in the ordinary course of business which has not yet been invoiced.

Trade receivables and accrued income are initially recognised at the transaction price and are subsequently measured at amortised cost less a provision for impairment using the expected loss model.

1 Summary of significant accounting policies (continued)

(j) Trade and other payables

Trade payables are initially recognised at amortised cost and subsequently measured at amortised cost. Due to their short maturities, the fair value of trade and other payables approximates their book values.

(k) Inventories

Inventories are stated at the lower of weighted average cost and net realisable value.

Where applicable, cost comprises direct materials and direct labour costs as well as those overheads that have been incurred in bringing the inventories to their present location and condition.

(l) Tax

The tax charge for the period is recognised in the income statement, the statement of comprehensive income or directly in equity according to the accounting treatment of the related transaction. The tax charge comprises both current and deferred tax.

Current tax assets and liabilities are measured at the amounts expected to be recovered from or paid to the tax authorities. The tax rates and tax laws used to compute the amounts are those that have been enacted or substantively enacted by the reporting date.

The calculation of the total tax charge involves a degree of estimation and judgement, and management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and establishes positions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred tax is provided using the balance sheet liability method and is recognised on temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit or loss.

Deferred tax liabilities are generally recognised on all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. However, deferred tax assets and liabilities are not recognised if the temporary differences arise from the initial recognition of goodwill or from the initial recognition of other assets and liabilities in a transaction (other than a business combination) that affects neither the accounting nor the taxable profit or loss.

Deferred tax liabilities are recognised on taxable temporary differences arising on investments in subsidiaries and jointly controlled entities except where the company is able to control the reversal of the temporary differences and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based on the tax rates and tax laws that have been enacted or substantively enacted by the reporting date.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the deferred tax asset to be recovered. Unrecognised deferred tax assets are reassessed at each reporting date and are recognised to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

1 Summary of significant accounting policies (continued)

(l) Tax (continued)

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same tax authorities and the company intends to settle their current tax assets and liabilities on a net basis.

(m) Provisions for liabilities

Provisions for liabilities are recognised where a legal or constructive obligation exists at the reporting date, as a result of past events where the amount of the obligation can be reliably estimated and where the outflow of economic benefit is probable.

Provision is made for decommissioning and environmental costs, based on future estimated expenditure, discounted to present values. An initial estimate of decommissioning and environmental costs attributable to property, plant and equipment is recorded as part of the original cost off the related property, plant and equipment.

Changes in the provision arising from revised estimates or discount rates or changes in the expected timing of expenditures that relate to property, plant and equipment are record as adjustments to their carrying value and depreciated prospectively over their remaining estimated useful economic lives; otherwise such changes are recognised in the income statement.

Other provisions consist of provisions not covered by insurance including employer liability claims, dilapidations and other provisions related to the operation of our gas networks. Where amounts are material, third party valuations are performed.

(n) Dividends

Dividend income is recognised when the right to receive payment is established. Dividend distributions to the company’s shareholders are recognised as a liability in the company’s financial statements in the period in which the dividends are approved by the company’s shareholders.

(o) Revenue

Revenue comprises sales value derived from the distribution of gas, including an assessment of the value of services provided, but not invoiced, at the period end. It excludes value added tax and intra-Group sales.

The sales value for the distribution of gas is largely determined from the amount of system capacity sold for the year, and the amount of gas transported for the year, evaluated at contractual prices on a monthly basis.

When revenue for the year exceeds the maximum amount permitted by the regulatory agreement, adjustments will be made to future prices to reflect this over-recovery, a liability for the over-recovery is not recognised as such an adjustment to future prices relates to the provision of future services. Similarly, an asset is not recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under-recovery.

Other income comprises all activities outside the regulated business, including customer contributions received for altering, diverting or relocating a tangible fixed asset. Post IFRS 15, revenue from customer contributions is now recognised when the performance obligations are satisfied.

1 Summary of significant accounting policies (continued)

(p) Exceptional items and remeasurements

Management utilises an exceptional items framework that follows a three-step process which considers the nature of the event, the financial materiality involved and any particular facts and circumstances. In considering the nature of the event, management focuses on whether the event is within the Group's control and how frequently such an event typically occurs. In determining the facts and circumstances management considers factors such as ensuring consistent treatment between favourable and unfavourable transactions, precedent for similar items, number of periods over which costs will be spread or gains earned and the commercial context for the particular transaction.

Items of income or expense that are considered by management for designation as exceptional items include such items as significant restructurings, write-downs or impairment of non-current assets, significant changes in environmental or decommissioning provisions, integration of acquired businesses, gains or losses on disposals of businesses or investments and debt redemption costs as a consequence of transactions such as significant disposals or issues of equity.

Remeasurements comprise gains or losses recorded in the income statement arising from the changes in fair value of derivative financial instruments to the extent that hedge accounting is not achieved or it not effective. These fair values increase or decrease because of changes in financial indices and prices over which we have no control.

(q) Pensions

The Group operates various post-employment schemes, including both defined benefit (DB) and defined contribution (DC) pension plans.

For DC pension plans, the Group pays contributions into separate funds on behalf of the employee and has no further obligations to employees. The risks associated with this type of plan are assumed by the member.

For DB pension plans, members receive benefits on retirement, the value of which is dependent on factors such as salary and length of pensionable service. The cost of providing benefits in a DB plan is determined using the projected unit method, with actuarial valuations being carried out at each reporting date by a qualified actuary. This valuation method is an accrued benefits valuation method that makes allowance for projected earnings.

The Group's obligation in respect of DB pension plans is calculated separately for each plan by projecting the estimated amount of future benefit payments that employees have earned for their pensionable service in the current and prior periods. These future benefit payments are discounted to determine the present value of the liabilities and the fair value of plan assets and any unrecognised past service cost is then deducted. The discount rate used is the yield at the valuation date on high-quality corporate bonds with terms similar to the period over which liabilities will be paid.

The Group takes advice from independent actuaries relating to the appropriateness of any key assumptions applied which include life expectancy of members, expected salary and pension increases, and inflation. It should be noted that comparatively small changes in the assumptions used may have a significant effect on the amounts recognised in the income statement and the statement of other comprehensive income and the net liability recognised in the statement of financial position.

Remeasurements of net retirement obligations are recognised in full in the period in which they occur in the statement of other comprehensive income.

1 Summary of significant accounting policies (continued)

(r) Leases

Leases in which substantially all of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Operating lease payments are charged to the income statement on a straight-line basis over the term of the lease.

Assets for use in the Group's business where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments and are included in property, plant and equipment and depreciated accordingly.

The obligations related to finance leases, net of finance charges in respect of future years, are included within borrowings. The interest element of the rental obligation is charged to the income statement over the lease term so as to produce a constant periodic rate of interest on the remaining balance of the obligation for each accounting period.

(s) Cash and cash equivalents

For the purpose of presentation in the statement of cash flows, cash and cash equivalents includes cash on hand, deposits held at call with financial institutions, other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities in the balance sheet.

2 Critical accounting judgements and key sources of estimation uncertainty

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

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

Areas of judgement that have the most significant effect on the amounts recognised in the financial statements are as follows:

- The recognition of a surplus in respect of the defined benefit pension scheme reflects legal and actuarial advice that we have taken regarding recognition of surpluses under IFRIC 14– note 27.
- The categorisation of certain items as exceptional items under the exceptional item framework that follows a three - step process which considers the nature of the event, materiality involved and any particular facts and circumstances. Management focuses on whether the event is within the Group's control and how frequently such an event typically occurs– note 6.
- The allocation of the purchase consideration across the various asset categories – note 12.
- The impairment of goodwill and intangible assets – note 12 and 13.

IFRS provides certain options available within accounting standards. Choices we have made, and continue to make, include the following:

- **Presentational formats:** we use the nature of expense method for our income statement and aggregate our statement of financial position to net assets and total equity. In the income statement, we present subtotals of total operating profit/(loss), profit/(loss) before tax and profit/(loss) from continuing operations, together with additional subtotals excluding exceptional items and remeasurements. Exceptional items and remeasurements are presented separately on the face of the income statement.
- **Financial instruments**: we normally opt to apply hedge accounting in most circumstances where this is permitted.

Key sources of estimation uncertainty that have significant risk of causing material adjustment to the carrying amounts of assets and liabilities in the next financial year are as follows:

- Review of residual lives, carrying values and impairment charges for intangible assets and property, plant and equipment including goodwill impairment – notes 13 and 14;
- Estimation of liabilities for pensions and other post-retirement benefits – note 27; and
- Environmental provision – note 23.

In order to illustrate the impact that changes in assumptions could have on our results and financial position, we have included sensitivity analysis in note 29.

3 Segmental analysis

The Directors believe that the whole of the Group's activities constitute one single segment. Operating segments are reported in the manner consistent with internal reporting to the Chief Operating Decision Maker, which has been identified as the Board of Directors.

The company's country of domicile is the United Kingdom and is the country in which it generates all of its revenue. The company's assets are all located within the United Kingdom.

4 Revenue

	2019	2018
	£m	£m
Revenue from distribution of gas	**1,890**	1,809
Other income	**96**	43
	1,986	1,852

As the modified retrospective approach has been adopted, other income includes £55m (2018: £Nil) due to the adoption of IFRS 15 in the year. See note 1(c) for further details regarding the adoption of IFRS 15.

Geographical analysis of revenue is not provided as the company's operations are all undertaken in the UK for customers based in the UK.

Analysis of revenue by major customer

	2019	2018
	£m	£m
Customer A	**480**	505
Customer B	**204**	141
	684	646

Two customers contributed 10% or more to the Group's revenue during the year to 31 March 2019 (2018: One).

5 Operating profit/(loss)

	2019	2018
	£m	£m
Operating profit/(loss) is stated after charging/(crediting):		
Depreciation and amortisation	**369**	354
Payroll costs (see note 7)	**200**	192
Inventory consumed	**13**	9
Purchases of gas	**25**	20
Rates	**204**	198
Operating leases	**8**	8
Research and development expenditure	**6**	8
Goodwill impairment charges	**1,372**	-

Included within operating profit is an amount of £8.9m relating to a financial contribution to the Energy Savings Trust. The contribution was a result of the conclusion of discussions with Ofgem in relation to historical challenges, set out in subsequent public statements.

	2019	2018
Services provided by the company's auditor	**£'000**	£'000
Audit services		
Audit of parent company and consolidated financial statements	**52**	50
Audit of subsidiary company financial statements	**559**	583
Other services		
Fees payable to the company's auditor for audit-related assurance services	**118**	72
Other non-audit services	**163**	113

Fees payable to the company's auditor for audit-related assurance services represent fees payable for services in relation to engagements which are required to be carried out by the auditor such as interim reviews. Other non-audit services in 2019 relate to services provided in connection with the raising of debt or required by the regulator.

6 Exceptional items and remeasurements

	2019	2018
	£m	£m
Exceptional items included within operating costs:		
Goodwill impairment (i)	**(1,372)**	-
Separation activities (ii)	**(16)**	(20)
Restructuring costs (iii)	**(3)**	-
Guaranteed minimum pension (iv)	**(14)**	-
	(1,405)	(20)
Remeasurements included within finance costs:		
Net losses on derivative financial instruments (v)	**(13)**	-
Total included within profit before tax	**(1,418)**	(20)
Included within taxation:		
Tax on separation activities	**3**	4
Tax on restructuring costs	**1**	-
Tax on guaranteed minimum pension	**2**	-
Tax on remeasurements	**2**	-
	8	4
Total exceptional and remeasurements after tax	**(1,410)**	(16)
Analysis of total exceptional items and remeasurements after tax		
Total exceptional items after tax	**(1,399)**	(16)
Total remeasurements after tax	**(11)**	-
	(1,410)	(16)

(i) A goodwill impairment was recognised in the year, see note 13 for details.

(ii) As a result of the acquisition of Cadent Gas Limited, a number of separation activities have arisen, which are exceptional by nature as this is not in the ordinary course of the business.

(iii) The Group is undergoing a reorganisation exercise. These activities are infrequent and exceptional in nature and will continue into the next financial year, so is financially material.

(iv) A pre-tax exceptional expense of £14m has been recorded in the year ended 31 March 2019 as a past service cost in respect of the equalisation of guaranteed minimum pension ("GMP") benefits. On 26 October 2018, the High Court handed down a judgement involving Lloyds Banking Group defined benefit pension schemes. The judgement concluded that the schemes should equalise pension benefits for men and women in relation to GMP benefits.

(v) Net losses on derivative financial instruments comprise gains and losses arising on derivative financial instruments reported in the income statement. These exclude gains and losses for which hedge accounting has been effective, which have been recognised directly in other comprehensive income or which are offset by adjustments to the carrying value of debt.

7 Employment costs

The average number of persons (including Executive Directors) employed by the Group was 4,062 (2018: 4,102) and can be analysed as follows:

	2019	2018
Field Force	**1,726**	1,756
Office and other administrative staff	**2,336**	2,346
	4,062	4,102

	2019 £m	2018 £m
Wages and salaries	**182**	180
Social security costs	**22**	22
Other pension costs	**52**	42
	256	244
Less: payroll costs capitalised	**(56)**	(52)
	200	192

Key management comprises the Board of Directors of the company and its principle subsidiary, Cadent Gas Limited, including Executive and Non-executive Directors who have managerial responsibilities of the business.

	2019 £'000	2018 £'000
Salaries and other short-term employee benefits	**1,699**	1,410
Post-employment benefits	**130**	492
	1,829	1,902

8 Directors emoluments

The Directors' emoluments were as follows:

	2019 £m	2018 £m
Aggregate emoluments (including salary, fees, bonuses and benefits-in-kind)	**1,699**	1,410
Pension schemes	**130**	492
	1,829	1,902

There were no amounts paid to third parties for Directors' services.

Post-employment benefits were being accrued for one (2018: One) Director under a defined benefit scheme.

8 Directors emoluments (continued)

Highest paid Director

The highest paid Director's emoluments for the Group were as follows:

	2019 £'000	2018 £'000
Total amount of emoluments and amounts receivable (excluding shares) under long-term incentive schemes	**804**	713
Defined benefit pension scheme		
– accrued pension at end of period	**75**	444

9 Finance income and costs

	2019 £m	2018 £m
Finance income		
Pension interest income	**14**	2
Interest income from financial instruments	**2**	1
Finance income	**16**	3
Finance costs		
Interest expense on financial liabilities held at amortised cost:		
Bank loans and overdrafts	**47**	59
Other borrowings	**149**	125
Interest payable on intercompany financing	**59**	71
Derivatives	**9**	15
Unwinding of discounts on provisions	**-**	2
Less: interest capitalised (i)	**-**	-
Finance costs	**264**	272
Remeasurements		
Net gains/(losses) on derivative financial instruments included in remeasurements (ii):		
Ineffectiveness on derivatives designated as:		
Cash flow hedges	**(5)**	11
Derivatives not designated as hedges or ineligible for hedge accounting	**18**	(11)
Remeasurements included within finance costs	**13**	-
Finance costs	**277**	272
Net finance costs	**261**	269

i) Interest on funding attributable to assets in the course of construction was capitalised during the period at a rate of 2.2% (2018: 2.2%). Capitalised interest of £Nil (2018: £128,000) qualifies for a current year tax deduction with tax relief claimed of £Nil (2018: £24,000).

ii) Includes a net foreign exchange gain on financing activities of £5m (2018: £17m loss). These amounts are offset by foreign exchange gains and losses on derivative financial instruments measured at fair value.

10 Taxation

Tax charged to the income statement

	2019 £m	2018 £m
Tax before exceptional items and remeasurements	**98**	80
Tax on total exceptional items and remeasurements (note 6)	**(8)**	(4)
Total tax charge	**90**	76

Taxation as a percentage of profit before tax

	2019 %	2018 %
Before exceptional items and remeasurements	**18.4**	20.1
After exceptional items and remeasurements	**(10.2)**	20.1

The tax charge for the period can be analysed as follows:

	2019 £m	2018 £m
Current tax		
UK corporation tax at 19% (2018: 19%)	**110**	103
UK corporation tax adjustment in respect of prior years	**(3)**	(1)
Total current tax	**107**	102
Deferred tax		
UK deferred tax	**(15)**	(28)
UK deferred tax adjustment in respect of prior years	**(2)**	2
Total deferred tax	**(17)**	(26)
Total tax charge	**90**	76

Tax charged to other comprehensive income and equity

	2019 £m	2018 £m
Deferred tax		
Accelerated tax depreciation	**1**	**-**
Remeasurements of net retirement benefit obligations	**23**	**75**
Cash flow hedges	**-**	**2**
Total tax charged to other comprehensive income and equity	**24**	**77**

10 Taxation (continued)

The tax charge for the period after exceptional items and remeasurements is lower (2018: higher) than the standard rate of corporation tax in the UK of 19% (2018 19%):

	Before exceptional items and Remeasure-ments 2019 £m	**After exceptional items and Remeasure-ments 2019 £m**	Before exceptional items and Remeasure-ments 2018 £m	After exceptional items and Remeasure-ments 2018 £m
Profit/(loss) before tax				
Before exceptional items and remeasurements	**534**	**534**	399	399
Exceptional items and remeasurements	**-**	**(1,418)**	-	(20)
Profit/(loss) before tax	**534**	**(884)**	399	379
Profit/(loss) before tax multiplied by UK corporation tax rate of 19% (2018: 19%)	**101**	**(168)**	76	72
Effect of:				
Expenses not deductible for tax purposes	**4**	**265**	2	2
Non-taxable income	**(1)**	**(1)**	(1)	(1)
Corporation tax/deferred tax rate differential	**(1)**	**(1)**	1	1
Other	**-**	**-**	1	1
Prior year adjustments	**(5)**	**(5)**	1	1
Total tax	**98**	**90**	80	76

Factors that may affect future tax charges

The Finance Act 2016 was enacted on 15 September 2016. The Act reduced the corporate tax rate to 17% from 1 April 2020. Deferred tax balances forecast to reverse in the period to 31 March 2020 have been provided for at 19%. Deferred tax balances forecast to reverse in the period after 31 March 2020 have been provided for at 17%. The tax impact of new accounting standards have been included in note 1c on page 25 where appropriate.

10 Taxation (continued)

Taxation included within the statement of financial position

The following are the major deferred tax assets and liabilities recognised, and the movements thereon, during the current reporting period:

	Accelerated tax depreciation £m	Gas distribution licence £m	Pensions £m	Financial instruments £m	Other net temporary differences £m	Total £m
At 1 April 2018	1,481	364	82	(4)	(2)	1,921
Charged/(credited) to income statement	(20)	-	12	(1)	(8)	(17)
Charged to other comprehensive income and equity	1	-	23	-	-	24
At 31 March 2019	**1,462**	**364**	**117**	**(5)**	**(10)**	**1,928**
Deferred tax assets at 31 March 2019	-	-	-	(5)	(10)	(15)
Deferred tax liabilities at 31 March 2019	1,462	364	117	-	-	1,943
At 31 March 2019	**1,462**	**364**	**117**	**(5)**	**(10)**	**1,928**

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net. The deferred tax balances (after offset) for statement of financial position purposes consist solely of deferred tax liabilities of £1,928m (2018: £1,921m).

11 Dividends

	2019 **£m**	2018 £m
Interim dividend of 3.77 pence per ordinary share amounting to £185,500,000 was paid on the 22 November 2017	-	186
Second interim dividend of 3.59 pence per ordinary share amounting to £183,200,000 was declared on the 23 March 2018 and paid on the 27 March 2018	-	183
Interim dividend of 3.33 pence per ordinary share amounting to £170,000,000 was declared and paid on the 28 September 2018	170	-
Second interim dividend of 3.33 pence per ordinary share amounting to £170,000,000 was declared on the 21 March 2019 and paid on the 27 March 2019	170	-
	340	369

No further dividends are proposed for the current financial period.

12 Business combination

On 31 March 2017, Quadgas MidCo Limited acquired 100% of the share capital of Cadent Gas Limited including its subsidiary, Cadent Finance Plc, and 100% of the share capital of Cadent Services Limited for £7,744 million, funded through intercompany loans from its parent company and external borrowings. The acquisition by Quadgas MidCo Limited was part of a plan announced in November 2015 by National Grid Plc to sell a majority stake of its gas distribution networks.

The Group has applied IFRS 3 'Business Combinations'. The acquisition has been accounted for using the acquisition method with the difference between the fair value of the consideration and the fair value of the net assets acquired recognised as goodwill. For Cadent Services Limited the consideration was equal to the book value.

The Group completed a purchase price allocation exercise for the acquisition. Provisional allocations were completed in the prior year accounts. A purchase price allocation exercise was undertaken for its interest in Cadent Gas Limited and Cadent Service Limited, resulting in a fair value uplift. The table below shows the final allocations. The fair value of assets and liabilities acquired were as follows:

	Cadent Gas*	Cadent Services	Fair value uplift	Total
	£m	£m	£m	£m
Intangible assets – Software	88	-	-	88
Intangible assets – Licence	-	-	2,143	2,143
Property, plant and equipment	8,509	36	1,785	10,330
Net pension asset	34	-	-	34
Inventories	7	-	-	7
Trade and other receivables	277	1	(6)	272
Net derivative financial instruments	(9)	-	-	(9)
Current asset investments	59	-	-	59
Cash and cash equivalents	-	5	-	5
Trade and other payables	(376)	(31)	23	(384)
Borrowings	(6,042)	-	(25)	(6,067)
Tax liabilities	(67)	-	-	(67)
Provisions	(103)	(6)	-	(109)
Capital contributions > 1 year	(855)	-	855	-
Deferred tax liability	(1,057)	-	(813)	(1,870)
	465	5	3,962	4,432

* Including its subsidiary Cadent Finance Plc

Consideration paid**	7,744
Goodwill at acquisition (representing the excess of consideration over the fair value of assets acquired)	3,312
Goodwill impairment charge	(1,372)
Goodwill at 31 March 2019	1,940

An impairment charge of £1,372 million was recognised during the year. See note 13 for further information.

**The consideration paid of £7,744m includes a price adjustment of £33m based on a final valuation, of which £13m was non-cash settled through related party loans.

12 Business combination (continued)

Goodwill encompasses the management related portion of incentive income, an element of financial outperformance, the benefit of a clean capital structure on acquisition and the established workforce.

The acquisition has had a £1,986m impact on revenue and £974m on loss for the year after the goodwill impairment charge.

13 Intangible assets

	Goodwill £m	Licence £m	Software £m	Total £m
Cost:				
At 1 April 2018	3,312	2,143	90	5,545
Additions	-	-	30	30
Disposals	-	-	-	-
At 31 March 2019	**3,312**	**2,143**	**120**	**5,575**
Accumulated amortisation:				
At 1 April 2018	-	-	(31)	(31)
Amortisation charge for the period	-	-	(26)	(26)
Impairment	(1,372)	-	-	(1,372)
Disposals	-	-	-	-
At 31 March 2019	**(1,372)**	**-**	**(57)**	**(1,429)**
Net book value:				
At 31 March 2019	**1,940**	**2,143**	**63**	**4,146**
At 31 March 2018	3,312	2,143	59	5,514

On 31 March 2017, Quadgas MidCo Limited acquired 100% of the share capital of Cadent Gas Limited including its subsidiary, Cadent Finance Plc, and 100% of the share capital of Cadent Services Limited for £7,744 million, funded through intercompany loans from its parent company and external borrowings. At the time, the Group applied IFRS 3 ‘Business Combinations’ and the acquisition was accounted for using the acquisition method with the difference between the fair value of the consideration and the fair value of the net assets acquired recognised as goodwill. As part of this purchase price allocation exercise, goodwill of £3,312m was recognised together with an intangible for the gas distribution Licence of £2,143m.

Ofgem provide the business with an exclusive right to operate, invest in the infrastructure and earn a fair return on that invested capital over a 25-year daily renewing basis governed by a comprehensive regulatory framework. On the basis that the Licence gives the owner the right to operate and invest in the gas distribution networks within the licenced geographic area, the Licence has been separately recognised and valued as part of the purchase price allocation (see note 12). An indefinite useful economic life has been assumed for the Licence due to the daily renewing basis.

Goodwill encompasses the management related portion of incentive income, an element of financial outperformance, the benefit of a clean capital structure on acquisition and the established workforce.

Goodwill is recognised as an asset and is not amortised but is tested for impairment annually or more frequently if events or circumstances indicate a potential impairment. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

13 Intangible assets (continued)

Goodwill is allocated to cash generating units that are expected to benefit from the business combination in which goodwill arose. The cash generating unit has been determined as the level of Quadgas MidCo Limited as this is the smallest identifiable Group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or Group of assets.

Impairment Testing of goodwill and intangibles with an indefinite life

During the year, management completed the annual impairment test required for the goodwill and indefinite life intangibles that is holds on its balance sheet. The impairment test required the comparison of the carrying value of the net assets of income generating unit (Quadgas MidCo Limited) and its recoverable amounts. Management had been reviewing Ofgem announcements on RIIO-2 during the course of the year given the potential impact on the recoverable amount. On 18 December 2018, Ofgem published the RIIO-2 Sector Specific Methodology that provided firmer and more detailed guidance on the regulatory cost of capital, totex sharing factors and CPIH inflation change. On the 24 May 2019 Ofgem published its RIIO-2 Sector Specific Methodology Decision which provided an up-dated range for the regulatory cost of capital and more detail on how other amendments to regulatory mechanisms will be implemented. The value in use reduced as a result of lower return expectations set out in the Sector Specific Decision Document.

This calculation indicated that the recoverable amount was lower than the carrying amount and an impairment charge of £1,372m was recognised within exceptional items in the income statement. Under the requirements of IAS 36, this impairment was allocated to the goodwill balance of the cash generating unit (the business of gas distribution at the total Quadgas MidCo Limited level) and an impairment loss of £1,372m was recognised against the goodwill balance.

The recoverable amount of the cash generating unit was determined from value in use calculations. The key assumptions for the value in use calculation are those regarding the underlying cash flows, discount rate, regulatory weighted average cost of capital, inflation and terminal value cashflow.

The cashflow forecast for Cadent Gas Ltd has reflected the recent guidance from Ofgem including Management's assessment of the Ofgem range of potential regulatory cost of capital in RIIO-2 and looking further ahead to RIIO-3 and beyond (Ofgem guidance RIIO-2: Low: 4.0%: High 5.6% for Cost of Equity; and up-dated indexation for cost of debt allowances); a proposed reduction in totex sharing factor (Ofgem guidance: 15% - 50%: Current level of c. 63%); and a change in inflation methodology from the current RPI based price control to CPIH from RIIO-2. Management have used the Ofgem ranges when deciding on the variables used in the cashflow forecast. The long run inflation rate applied of 2.15% (CPIH) is based on market forecasts. The cashflows of Cadent Gas Ltd are relatively well insulated for any potential impact of Britain leaving the European Union. The forecast macro-economic impact is included in our value in use assumptions.

The Group prepares cash flow forecasts derived from the most recent business plan approved by management to the end of RIIO-1. Cashflows are forecast to 2045 based on detailed assumptions. A terminal value cash flow is applied in 2045. The terminal value is calculated based a RAV forecast multiple at 2045. The terminal value RAV multiple of 1.2 has been derived by reviewing external sources of information on similar transactions.

IAS 38 states that projections based on budgets and forecasts should cover a maximum of five years whereas management has used projections out to 2045. However, management believe that whilst there is uncertainty when moving from one price control period in to the next, there is a relative stable regulatory environment resulting in predictable cash flows beyond the immediate price control period.

Cashflow projections have been discounted to reflect the time value of money, using a pre-tax discount rate of 5.7%. Management estimates discount rate using post-tax rates that reflect current market assessments of the time value of money and then converts to a pre-tax rate using an iterative calculative approach in the value in use methodology. Further sensitivity and key assumptions are included in note 29.

14 Property, plant and equipment

	Land and buildings £m	Plant and Machinery £m	Assets in the course of construction £m	Motor vehicles and other equipment £m	Total £m
Cost					
At 1 April 2018	83	10,736	20	98	10,937
Additions	6	606	74	20	706
Reclassifications	-	7	(14)	7	-
Disposals	-	(1)	-	(1)	(2)
At 31 March 2019	**89**	**11,348**	**80**	**124**	**11,641**
Accumulated depreciation and impairment					
At 1 April 2018	(7)	(293)	-	(23)	(323)
Charge for the period	(7)	(310)	-	(26)	(343)
Disposals	-	1	-	1	2
At 31 March 2019	**(14)**	**(602)**	**-**	**(48)**	**(664)**
Net book value:					
At 31 March 2019	**75**	**10,746**	**80**	**76**	**10,977**
At 31 March 2018	76	10,443	20	75	10,614

Included within plant and machinery cost is £1,785m and plant and machinery depreciation is £96m relating to fair value adjustments arising from the acquisition of Cadent Gas Limited.

The net book value of motor vehicles and other equipment at 31 March 2019 includes £5,771,000 (2018: £5,845,000) relating to assets purchased under finance leases.

The cost of property, plant and equipment at 31 March 2019 includes £1,462,000 (2018: £1,462,000) relating to interest capitalised, with £ Nil (2018: £128,000) capitalised during the year.

The net book value of land and buildings comprises:

	2019 £m	2018 £m
Freehold	**53**	51
Long leasehold (over 50 years)	**-**	-
Short leasehold (under 50 years)	**22**	25
	75	76

15 Investments in associates

The Group's only associate is in respect of its 45.57% equity stake in Xoserve Limited, which was previously fully impaired.

	Total £m
Cost	
At 1 April 2018 & 31 March 2019	-
Provision	
At 1 April 2018 & 31 March 2019	-
Net book value	
At 31 March 2018 & 31 March 2019	-

At the point of acquiring Cadent Gas Limited, its investment in Xoserve Limited of £456 had been fully impaired.

Details of the associate undertaking are set out below:

Company	Class of share held	Place of business and country of incorporation	Percentage held	Principal activities
Xoserve Limited	Ordinary share of £0.01 designated as an A Share in the capital of the company	Registered address Lansdowne Gate, 65 New Road, Solihull, B91 3DL. Incorporated in England and Wales.	45.57%	Gas transportation transaction services

16 Inventories

	2019 £m	2018 £m
Raw materials and consumables	**10**	6
	10	6

Inventories are stated after provisions for impairment of £307,000 (2018: £318,000).

17 Trade and other receivables

	2019 £m	2018 £m
Amounts falling due within one year:		
Trade debtors	**16**	27
Other debtors	**12**	16
Prepayments and accrued income	**191**	194
	219	237
Amounts falling due after more than one year:		
Prepayments and accrued income	**29**	36
Other debtors	**15**	14
	44	50

In determining the recoverability of trade and other receivables the Group considers any change in credit worthiness of the counterparty from the date credit was initially granted up to the reporting date.

The movement in loss allowance for the year was as follows:

	2019 £m	2018 £m
At 1 April	**4**	4
Amounts utilised/written off in the year	**-**	-
Amounts credited to the income statement	**(1)**	-
At 31 March	**3**	4

The impact on the opening provision moving from the IAS 39 incurred cost model to the IFRS 9 expected loss model is £Nil.

When judging if a financial asset should be valued using the lifetime expected loss calculation the Group needs to assess if there has been a significant increase in credit risk.

The Group takes a simplified approach and considers all receivables to be in stage 2 immediately. When assessing if a financial asset has reached level 3 (credit impaired), the following information is considered:

- existing or anticipated adverse changes in economic conditions that are expected to lead to a significant decrease in the counterparty's ability to meet its debt obligations;
- actual or expected significant reduction of the profitability of the counterparty; and
- significant movement in credit risk derived from observable market data relating to the same or similar counterparty.

The impairment under the expected credit loss has been calculated by grouping customers into two distinct segments with significantly different customer bases and customer credit profiles. These segments are distinguished as follows:

- Other income: diversions receivables, damages receivables, emergencies receivables, and other receivables.
- Shipper income: capacity accrued income, commodity accrued income.

17 Trade and other receivables (continued)

Other income

Other income included within trade debtors relates to any income stream which involves rechargeable construction work done on the network where the costs can be charged to another party. Examples of other income would be diversions of gas pipes, charges for damages to gas pipes and rechargeable emergency repairs.

The loss allowance of the receivable balance is calculated using the expected loss model, and is calculated using a matrix based on the number of days past due plus any specific adjustments. Specific adjustments have been made based on forward looking information specific to any counterparty or counterparty segment which would lead the Group to adjust the normal matrix based calculation.

2019

	Not due	Current	1-6 months	6-12 months	Over 1 year	Total
	£m	£m	£m	£m	£m	£m
Total balance	6	3	2	1	7	**19**
Expected credit loss	-	-	(1)	-	(2)	**(3)**
Balance after loss allowance	**6**	**3**	**1**	**1**	**5**	**16**

Shipper Income

Shipper income relates to all income received from gas shippers and is included within prepayments and accrued income. These amounts relate to two different elements, capacity and commodity income.

The Group minimises customer credit risk by ensuring all customers can adequately demonstrate the ability to pay debts as they fall due. These include company credit rating, letter of credit from a financial institution, parent company guarantee, independent assessment, payment history allowance and advanced cash deposits.

Due to the credit risk control practices outlined above the Group expects to be able to reduce the credit exposure to near zero before any shipper customer balances becomes level 3.

2019

	Not due	Current	1-6 months	6-12 months	Over 1 year	Total
	£m	£m	£m	£m	£m	£m
Total balance	166	-	-	-	-	**166**
Expected credit loss	-	-	-	-	-	**-**
Balance after loss allowance	**166**	**-**	**-**	**-**	**-**	**166**

18 Derivative financial instruments

The fair values of derivative financial instruments are as follows:

	2019 Assets	**2019** Liabilities	**2019** Total
	£m	**£m**	**£m**
Amounts falling due within one year	**-**	**-**	**-**
Amounts falling due after more than one year	**8**	**(38)**	**(30)**
	8	**(38)**	**(30)**

	2018 Assets	2018 Liabilities	2018 Total
	£m	£m	£m
Amounts falling due within one year	5	(3)	2
Amounts falling due after more than one year	13	(9)	4
	18	(12)	6

For each class of derivative the notional contract amounts* are as follows:

	2019	2018
	£m	£m
Cross-currency interest rate swaps	**895**	676
Inflation linked swaps	**400**	400
	1,295	1,076

*The notional contract amounts of derivatives indicate the gross nominal value of transactions outstanding at the reporting date.

19 Current asset investments

	2019	2018
	£m	£m
Investments in short-term money funds	**339**	160
Loans to other entities	**-**	1
	339	161

20 Trade and other payables

	2019	2018
	£m	£m
Trade creditors	**276**	213
Other tax and social security	**45**	51
Other creditors	**28**	24
Accruals and deferred income	**211**	133
	560	421

Due to the short term nature of trade creditors, the fair value approximates its book value.

21 Accruals and deferred income

	2019	2018
	£m	£m
Accruals and deferred income	**27**	58
	27	58

Accruals and deferred income mainly comprises contributions to capital projects.

22 Borrowings

	2019	2018
	£m	£m
Amounts falling due within one year		
Bank loans	**2**	2
Bank overdrafts	**9**	5
Bonds	**54**	45
Finance leases	**1**	1
	66	53
Amounts falling due after more than one year		
Bank loans	**1,538**	2,578
Bonds	**7,031**	5,624
Amounts owed to parent company	**902**	902
Finance leases	**5**	6
	9,476	9,110

	2019	2018
	£m	£m
Total borrowings are repayable as follows:		
Less than 1 year	**66**	53
In 1-2 years	**-**	1,041
In 2-3 years	**1,250**	1
In 3-4 years	**-**	1,249
In 4-5 years	**91**	1
More than 5 years	**8,135**	6,818
	9,542	9,163

22 Borrowings (continued)

The notional amount of borrowings outstanding as at 31 March 2019 was £8,901m (2018: £8,570m), £9,171m (2018: £8,803m) including accretion.

The Group's borrowings comprise a mixture of listed and unlisted fixed rate, floating rate and indexed linked debt. Listed debt has been issued out of or novated into the Group's finance conduits, Cadent Finance Plc and Quadgas Finance Plc, unlisted debt has been issued out of or novated into Cadent Gas Limited and Quadgas MidCo Limited. The table below summarises the bank and bond debt, including their fair values.

Summary of Borrowings **31-Mar-2019**

Currency	Type	Notional £m	Rate	Maturity Date	Book value £m	Fair Value £m
Fixed Rate						
GBP	Listed	650	Fixed	22/09/2021	646	651
EUR*	Listed	643	Fixed	22/09/2024	636	647
GBP	Listed	850	Fixed	22/09/2028	850	844
GBP	Listed	700	Fixed	22/09/2038	693	684
GBP	Listed	800	Fixed	22/09/2046	799	766
GBP	Listed	300	Fixed	21/03/2040	295	309
JPY**	Listed	68	Fixed	19/07/2033	69	68
GBP	Unlisted	100	Fixed	19/03/2031	100	103
USD***	Unlisted	151	Fixed	19/03/2031	154	158
GBP	Unlisted	200	Fixed	19/03/2034	200	207
GBP	Unlisted	225	Fixed	19/03/2039	225	232
GBP	Listed	125	Fixed	31/03/2037	125	130
GBP	Unlisted	902	Fixed	31/03/2037	902	902
GBP	Listed	149	Fixed	31/10/2027	149	152
GBP	Listed	103	Fixed	31/10/2029	103	104
GBP	Listed	40	Fixed	31/10/2032	40	40
USD*****	Listed	38	Fixed	31/10/2024	39	42
GBP	Listed	70	Fixed	30/08/2030	70	72
GBP	Listed	225	Fixed	30/08/2033	227	231
GBP	Listed	350	Fixed	17/09/2029	353	364
		6,689			**6,675**	**6,706**
Index Linked****						
GBP	Unlisted	79	RPI-linked	02/10/2023	92	91
GBP	Unlisted	78	RPI-linked	18/06/2024	88	87
GBP	Unlisted	78	RPI-linked	25/06/2024	88	87
GBP	Unlisted	78	RPI-linked	29/04/2024	89	89
GBP	Unlisted	77	RPI-linked	30/04/2024	87	89
GBP	Unlisted	77	RPI-linked	07/05/2024	88	89
GBP	Listed	142	RPI-linked	02/05/2039	231	225
GBP	Listed	146	RPI-linked	10/08/2048	262	257
GBP	Listed	146	RPI-linked	14/08/2048	259	253
GBP	Listed	280	RPI-linked	31/03/2042	279	281
GBP	Listed	42	RPI-linked	31/03/2037	42	43
GBP	Listed	79	RPI-linked	31/03/2042	80	75
GBP	Listed	79	RPI-linked	31/03/2037	81	78
		1,380			**1,766**	**1,744**
Floating Rate						
GBP	Unlisted	393	LIBOR +	14/10/2021	392	395
GBP	Unlisted	400	LIBOR +	27/03/2027	400	392
GBP	Unlisted	218	LIBOR +	31/03/2022	217	222
GBP	Unlisted	76	LIBOR +	31/03/2037	77	74
		1,087			**1,086**	**1,083**
Overdraft		**9**			9	9
Finance lease obligation		**6**			**6**	**6**
TOTAL		**9,171**			**9,542**	**9,548**

* Euro amount is €750m

** JPY amount is ¥10bn

*** USD amount is $200m

****Index Linked debt notional is the accreted value

*****USD amount is $50m

22 Borrowings (continued)

Cadent Finance plc issued £3,643m of fixed rate bonds on 22 September 2016 and £300m on 19 March 2018. On 19 July 2018, Cadent Finance plc further issued ¥10bn of fixed rate bonds, which was swapped to £68m at the same time. These were all issued under Cadent Finance's £6,000m Euro Medium Term Note Programme and are guaranteed by Cadent Gas Limited. On 19 March 2019, Cadent Finance issued £681m of private loan notes, of which $200m was swapped to £156m at the same time.

The unlisted index-linked debt was novated from National Grid Gas plc to Cadent Gas Limited on 1 October 2016 with the transfer made at fair value. Listed index-linked debt was either novated from National Grid Gas plc to Cadent Finance at fair value or raised in Quadgas MidCo Limited.

The floating debt is a combination of term debt drawn under the £1,700m term loan and RCF agreed in October 2016, and drawn for the first time immediately before the date of sale and debt issued to the European Investment Bank, drawn down on 27 March 2017.

New debt raised in the year by Quadgas MidCo Finance and loaned to Quadgas MidCo Limited amounted to £645 million as detailed below:

On 30 August 2018, the company issued £295 million of private fixed rate loan notes: £70 million maturing in August 2030 with a coupon rate of 3.29% and the remainder of £225 million maturing in August 2033 with a coupon rate of 3.42%.

On 17 September 2018, the company issued £350 million of fixed rate bonds maturing in September 2029 with a coupon of 3.375%. On 30 October 2018, the company listed the bonds on the London Stock Exchange.

On 28th September 2018, Quadgas MidCo repaid early the £646m (Term A) 3-year facility due 2020 and on 28th March 2019, Cadent Gas Limited repaid the £400m Term B loan facility.

The fair value of borrowings at 31 March 2019 was £9,548m. Where market values were available, the fair value of borrowings (Level 1) was £4,265m. Where market values were not available, the fair value of borrowings (Level 2) was £5,283m, calculated by discounting cash flows at prevailing interest rates. The notional amount outstanding of the debt portfolio at 31 March 2019 was £9,171m (including accretion).

Obligations under finance leases

	Minimum lease payments	
	2019	2018
	£m	£m
Amounts payable under finance leases:		
Within one year	**1**	**1**
In the second to fifth years inclusive	**4**	3
After five years	**2**	4
Less: future finance charges	**(1)**	(1)
Present value of lease obligations	**6**	7

22 Borrowings (continued)

Obligations under finance leases (continued)

	Present value of minimum lease payments	
	2019	2018
	£m	£m
Amounts payable under finance leases:		
Within one year	**1**	1
In the second to fifth years inclusive	**3**	2
After five years	**2**	4
Present value of lease obligations	**6**	7
Analysed as:		
Amounts due for settlement within 12 months (shown under current liabilities)	**1**	1
Amounts due for settlement after 12 months	**5**	6
	6	7

It is the Group's policy to lease certain of its motor vehicles and other equipment under finance leases. The average lease length is 8 years (2018: 8 years). For the year ended 31 March 2019, the average effective borrowing was 3.48% (2018: 3.49%). Interest rates are fixed at the contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

All lease obligations are denominated in sterling.

23 Provisions for liabilities

	Decommissioning	Environmental	Other	Total
	£m	**£m**	**£m**	**£m**
At 1 April 2018	7	38	50	95
Charged to the income statement	-	3	7	10
Utilised	(3)	(1)	(4)	(8)
Released to the income statement	-	-	(2)	(2)
Unwinding of discount	-	-	-	-
At 31 March 2019	**4**	**40**	**51**	**95**

	2019	2018
	£m	£m
Current	**15**	17
Non-current	**80**	78
	95	95

23 Provisions for liabilities (continued)

Decommissioning provision
The decommissioning provision represents expenditure relating to the demolition of gas storage facilities expected to be incurred until 2020.

Environmental provision
The environmental provision represents the estimated restoration and remediation costs relating to old gas manufacturing sites owned by the Group (discounted using a real rate of 1.0% (2018: 1.0%)). Cash flows are expected to be incurred between 2019 and 2069.

The principle uncertainties that affect the calculation of the provision for gas site decontamination are changes in the discount rate and the underlying quantum of cash flows which could be impacted by regulation, the accuracy of the site surveys, unexpected contaminants, transportation costs and the impact of alternative technologies. We have made our best estimate of the financial effect of these uncertainties in the calculation of the provision, but future material changes in any of the assumptions could materially impact on the calculation of the provision and hence the income statement. The provision incorporates our best estimate of the financial effect of these uncertainties, but future material changes in any of the assumptions could materially impact on the calculation of the provision.

The undiscounted amount of the provision at 31 March 2019 was £52m (2018: £51m), being the undiscounted best estimate liability having regard to these uncertainties.

Other provisions
The other provision represents all other provisions, including claims which are not covered by insurance.

24 Share capital

Allotted, called up and fully paid	**2019 £m**	2018 £m
5,105,581,781 ordinary shares of £0.0001 each	**1**	1

On 22 November 2017 the company issued a further 177,131,781 ordinary shares of £1 for consideration of £177,131,781.

On the 25 January 2018, the company completed a capital reduction. Prior to the capital reduction, share capital consisted of 5,105,581,781 ordinary shares of £1 that were allotted, called up and fully paid up. The capital reduction resulted in the share capital account being reduced by £5,105,071,223 to £510,558 by reducing the nominal value of the shares from £1 to £0.0001.

25 Net debt

	2019	2018
	£m	£m
(Decrease) / increase in cash and cash equivalents	(12)	30
Increase in financial investments	178	102
Increase in borrowings & related derivatives	(345)	(350)
Net interest paid on the components of net debt	207	197
Change in net debt arising from cash flows	28	(21)
Changes in fair value of financial assets and liabilities and exchange movements	(9)	15
Other non-cash changes	-	171
Net interest charge on the components of net debt	(264)	(270)
Movement in net debt (net of related derivative financial instruments)	(245)	(105)
Net debt (net of related derivative financial instruments) at the start of the period	(8,976)	(8,871)
Net debt (net of related derivative financial instruments) at the end of the period	(9,221)	(8,976)

Composition of net debt:

	2019	2018
	£m	£m
Cash, cash equivalents and financial investments	351	176
Borrowings and bank overdrafts	(9,542)	(9,158)
Derivatives	(30)	6
Total net debt	(9,221)	(8,976)

25 Net debt (continued)

Analysis of changes in net debt:

	Cash and cash equivalents £m	Bank overdrafts £m	Net cash and cash equivalents £m	Financial investments £m	Borrowings £m	Derivatives £m	Total £m
Cost							
At 1 April 2018	20	(5)	15	161	(9,158)	6	(8,976)
Cashflow	**(8)**	**(4)**	**(12)**	**178**	**(136)**	**(2)**	**28**
Fair value gains and losses and exchange movements	**-**	**-**	**-**	**-**	**16**	**(25)**	**(9)**
Interest charges	**-**	**-**	**-**	**-**	**(255)**	**(9)**	**(264)**
Other non-cash changes	**-**	**-**	**-**	**-**	**-**	**-**	**-**
At 31 March 2019	**12**	**(9)**	**3**	**339**	**(9,533)**	**(30)**	**(9,221)**

Balances at 31 March 2019 comprise:

Non-current assets	-	-	**-**	**-**	**-**	**8**	**8**
Current assets	**12**	**-**	**12**	**339**	**-**	**-**	**351**
Current liabilities	**-**	**(9)**	**(9)**	**-**	**(57)**	**-**	**(66)**
Non-current liabilities	**-**	**-**	**-**	**-**	**(9,476)**	**(38)**	**(9,514)**
At 31 March 2019	**12**	**(9)**	**3**	**339**	**(9,533)**	**(30)**	**(9,221)**

26 Capital and other commitments

	2019 £m	2018 £m
Contracts for future capital expenditure not provided in the financial statements	**387**	741
Letters of credit	**300**	300
	687	1,041

The Group had the following future minimum lease payments under non-cancellable operating leases for each of the following periods:

	2019 £m	2018 £m
Less than 1 year	**7**	8
In 2-5 years	**11**	10
More than 5 years	**9**	1
	27	19

In respect of the Group's commitment to property and vehicle leases, there are no contingent rentals payable, or restrictions on dividends, debt or further leasing imposed by these lease arrangements. Escalation of rents is via rent reviews at agreed intervals.

27 Pensions

The Group operates a number of pension schemes for its employees.

Defined contribution (DC) scheme

For DC pension plans, the company pays contributions into separate funds on behalf of the employee and has no further obligations to employees. The risks associated with this type of plan are assumed by the member.

MyPension was established on 1 April 2017 as the DC pension scheme for the company. Under the rules of the plan, the company double matches member contributions to MyPension up to a maximum of 6%. MyPension is the qualifying scheme used for automatic enrolment and new hires are enrolled into MyPension.

Prior to that, employees contributed to the National Grid YouPlan. At 31 August 2018 a bulk transfer of £85.5m was effected from YouPlan to MyPension and all DC benefits are now managed under MyPension.

The amount recognised as an expense for the defined contribution scheme was:

	2019 £m	**2018 £m**
Current period contributions	15	13

Defined benefit (DB) scheme

The company's DB pension arrangements are held in the National Grid UK Pension Scheme. With effect 1 January 2017 the scheme was split into three sections, each which is legally and actuarially separate. Section C is supported by the company and its membership is limited to the company's employees (active and deferred). Sections A and B are supported by companies within the National Grid Group.

27 Pensions (continued)

Members receive benefits on retirement, the value of which is dependent on factors such as salary and length of pensionable service. The company underwrites both financial and demographic risks associated with this type of plan.

The cost of providing benefits in a DB plan is determined using the projected unit method, with actuarial valuations being carried out at each reporting date by a qualified actuary. This valuation method is an accrued benefits valuation method that makes allowance for projected earnings.

The company's obligation in respect of the plan is calculated separately for Section C of the Scheme by projecting the estimated amount of future benefit payments that employees have earned for their pensionable service in the current and prior periods. These future benefit payments are discounted to determine the present value of the liabilities and the fair value of plan assets and any unrecognised past service cost is then deducted. The discount rate used is the yield at the valuation date on high-quality corporate bonds with terms similar to the period over which liabilities will be paid.

The company takes advice from independent actuaries relating to the appropriateness of any key assumptions applied which include life expectancy of members, expected salary and pension increases, and inflation. It should be noted that comparatively small changes in the assumptions used may have a significant effect on the amounts recognised in the income statement and the statement of other comprehensive income and the net asset recognised in the statement of financial position.

Remeasurements of net retirement obligations are recognised in full in the period in which they occur in the statement of other comprehensive income.

The National Grid UK Pension Scheme is a defined benefit pension scheme, funded with assets held in a separate trustee administered fund. The arrangements are managed by a trustee company with a board consisting of company and member appointed directors. The directors are required to manage the arrangements in accordance with local regulations and the arrangements' governing documents, acting on behalf of its beneficiaries.

The arrangements are subject to independent actuarial funding valuations at least every three years and following consultation and agreement with the company, the qualified actuary certifies the rate of employers' contribution, which, together with the specified contributions payable by the employees and proceeds from the scheme's assets, are expected to be sufficient to fund the benefits payable.

The last full actuarial valuation for the National Grid UK Pension Scheme was carried out at 31 March 2017. As part of this valuation, based on long-term financial assumptions, a contribution rate to meet future benefit accrual was agreed of 52.1% of pensionable earnings less any member contributions. In addition, the company makes payments to the scheme to cover administration costs and the Pension Protection Fund levy.

The results of the 2017 valuation are shown below:

Last full actuarial valuation	**31 March 2017**	**30 September 2015**
Actuary	**Willis Towers Watson**	**Willis Towers Watson**
Market value of scheme assets at latest valuation	**£7,004**	**£16,551m**
Actuarial value of benefits due to members	**£7,233**	**£18,176m**
Market value as percentage of benefits	**97%**	**91%**
Funding deficit	**£229m**	**£1,625m**

The figures for 2015 covers the whole of the Scheme as at that date, whereas the 2017 valuation covers only Section C, which is supported by the company. A valuation of Section C is currently being undertaken as at 31 March 2019.

27 Pensions (continued)

Section C of the National Grid UK Pension Scheme

The Group and the Trustees have agreed a schedule of contributions, under which payments of £37.1m will be made each year from September 2018 until September 2021 and £31.4m in 2022, adjusted for the change in RPI from 31 December 2016 to 3 months prior to the date of payment.

The Group has established a security arrangement with a charge in favour of the Trustees. This amount may change over time or following changes to the Group's credit rating or gearing levels. At 31 March 2019 the value of this was required to be £285m. This was provided via £300m in letters of credit. The assets held as security will be paid to Section C in the event that the Group is subject to an insolvency event, if the Group is given notice of less than 12 months that Ofgem intends to revoke its licence under the Gas Act 1986, if the Group fails to make the required contributions in relation to Section C, if the Group's credit rating by two out of three specified agencies falls below certain agreed levels for a period of 40 days, or if the Group grants any charges over its assets other than where agreed with the Trustees. The assets held as security will be released back to the Group if the scheme moves into surplus. In addition, the Group will make a further payment of £77m (increased in line with RPI) into Section C if the Group's credit rating by two out of three specified agencies falls below certain agreed levels for a period of 40 days.

The scheme ceased to allow new hires to join from 1 April 2002, with new hires since that date having the option of joining the DC arrangement.

Guaranteed Minimum Pension (GMP) equalisation

GMPs were intended to broadly replace State Earnings Related Pension Scheme (SERPS) benefits for members of contracted out occupational pension schemes from April 1978 to April 1997. Inequalities in GMP stemmed from the statutory definition of GMP, resulting in benefits accruing at different rates between male and female members.

A High Court judgement in October 2018 confirmed that GMP benefits need to be equalised between men and women, but importantly also provided alternative prescribed methods of equalisation. This provided much needed clarity, as there has been uncertainty in pensions law for decades, as it pertains to GMP equalisation.

However, the scheme cannot directly equalise the GMPS, but needs to adjust other benefits in order to achieve this, through correcting the ongoing position and making back-payments to affected members. This is a highly complex issue and we have estimated the cost of equalisation under the most effective permissible method to be £14m.

The key driver of this cost is the scheme's benefit structures, the membership profile and retirement choices made by members. Cadent Gas will continue to work closely with the Trustees, the actuaries and legal advisers to implement and administer GMP equalisation, which is expected to take some years.

Risks

The DB pension obligations and other post-retirement benefit liabilities are exposed to the primary risks outlined below.

Liabilities are calculated using discount rates set with reference to yields on high-quality corporate bonds prevailing in the UK debt markets and will fluctuate as yields change. Plan funds are invested in a variety of asset classes, principally: equities, government securities, corporate bonds and property. Consequently, actual returns will differ from the underlying discount rate adopted and therefore have an impact on the net balance sheet liability.

Changes in inflation will affect both current and future pension payments and are partially mitigated through investment in inflation matching assets and hedging instruments.

27 Pensions (continued)

Longevity is also a key driver of liabilities and changes in expected mortality will have a direct impact on liabilities. The liabilities are, in aggregate, relatively mature which serves to mitigate this risk to some extent.

Each plan's investment strategy seeks to balance the level of investment return sought with the aim of reducing volatility and risk. In undertaking this approach reference is made both to the maturity of the liabilities and the funding level of that plan. A number of further strategies are employed to manage underlying risks, including liability matching asset strategies, diversification of asset portfolios, interest rate hedging and management of foreign exchange exposure.

The recognition of the net defined benefit asset in relation to Section C of the National Grid UK Pension Scheme reflect legal and actuarial advice that we have taken regarding recognition of surpluses under IFRIC 14. We have concluded that the Group has an unconditional right to a refund from the plan, in the event of a winding-up. The Trustees must seek the agreement of the company to any benefit augmentation beyond the provisions set out in the Scheme Rules.

Amounts recognised in the statement of financial position

	2019 Total £m	2018 Total £m
Present value of funded obligations	(5,981)	(6,306)
Fair value of plan assets	6,674	6,816
	693	510
Present value of unfunded obligations	(3)	(3)
Other post-employment liabilities	-	-
Net defined benefit asset	690	507

Represented by:	2019 Total £m	2018 Total £m
Liabilities	(5,984)	(6,309)
Assets	6,674	6,816
	690	507

27 Pensions (continued)

Amounts recognised in the income statement and statement of other comprehensive income

	2019 Total £m	2018 Total £m
Included within operating costs		
Administration costs	3	3
Included within operating costs		
Defined contribution scheme costs	15	13
Defined benefit scheme costs:		
Current service cost	20	29
Past service cost (disclosed as an exceptional item)	14	-
Special termination benefit cost/(gain) – redundancies	-	(3)
	52	42
Included within operating costs		
Net interest (credit)	(14)	(2)
Total included in income statement	38	40
Remeasurements of net retirement benefit obligations	35	(433)
Return on plan assets (greater) or less than discount rate	(167)	(7)
Total included in the statement of other comprehensive income	(132)	(440)

Reconciliation of the net defined benefit asset

	2019 Total £m	2018 Total £m
Opening net defined benefit asset	507	34
Costs recognised in the income statement	(23)	(27)
Employer contributions	75	60
Other movements	131	440
Closing net defined benefit asset	**690**	**507**

Changes in the present value of defined benefit obligations (including unfunded obligations)

	2019 Total £m	2018 Total £m
Opening net defined benefit liability	6,309	6,970
Current service cost	20	29
Past service cost	14	-
Interest cost	156	162
Actuarial (gains)/losses – experiences	38	55
Actuarial (gains)/losses – demographic assumptions	(259)	(192)
Actuarial (gains)/losses – financial assumptions	256	(296)
Special termination benefit cost – redundancies	-	(3)
Benefits paid	(551)	(416)
Other	1	-
Closing net defined benefit liability	5,984	6,309

27 Pensions (continued)

Changes in the fair value of plan assets

	2019 Total £m	2018 Total £m
Opening fair value of plan assets	6,816	7,004
Interest income	170	164
Return on assets greater than assumed	167	7
Administration costs	(3)	(3)
Employer contributions paid	75	60
Employee contributions	-	-
Benefits paid	(551)	(416)
Closing fair value of plan assets	**6,674**	**6,816**
Actual return on plan assets	337	170
Expected contributions to plans in the following year	65	61

Asset allocations

Within the asset allocations below there is significant diversification across regions, asset managers, currencies and bond categories.

	2019 Quoted £m	2019 Unquoted £m	2019 Total £m	2018 Quoted £m	2018 Unquoted £m	2018 Total £m
Equities	717	248	965	714	270	984
Corporate bonds	1,844	-	1,844	2,020	-	2,020
Property	-	363	363	-	402	402
Government securities	2,944	-	2,944	2,857	-	2,857
Diversified alternatives (i)	-	401	401	-	388	388
Other	-	157	157	-	165	165
Total	5,505	1,169	6,674	5,591	1,225	6,816

i) Includes return seeking non-conventional asset classes of £312m (2018: £388m), secure income assets of £88m (2018: Nil) and other of £1m (2018: Nil).

The investment strategy for Section C of the National Grid UK Pension Scheme is formulated specifically in order to manage risk, through investment in diversified asset classes, including the use of liability matching assets and where appropriate through the employment of interest rate and inflation hedging instruments. The asset allocation at 31 March 2019 is as follows:

	2019 %	2018 %
Equities	**15**	**14**
Other	**85**	**86**
	100	**100**

27 Pensions (continued)

Actuarial assumptions

Cadent Gas Limited has applied the following financial assumptions in assessing defined benefit liabilities.

	2019	2018
	%	%
Discount rate – Past service (i)	**2.40**	2.60
Discount rate – Future service (i)	**2.45**	2.65
Rate of increase in salaries (ii)	**3.50**	3.40
Rate of increase in RPI – Past service (iii)	**3.25**	3.15
Rate of increase in RPI – Future service (iii)	**3.20**	3.10

i) The discount rate for pension liabilities has been determined by reference to appropriate yields on high quality corporate bonds prevailing in the UK debt market at the reporting date. Future and past discount rates are set based on the expected duration of scheme liabilities.

ii) A promotional scale has also been used w here appropriate. The assumption stated is that relating to service prior to 1 April 2014. The assumption for the rate of increase in salaries for service after this date is 2.20% (2018: 2.20%).

iii) This is the key assumption that determines assumed increases in pensions in payment and deferment. Consistent w ith the derivation of the discount rate, the RPI assumption reflects the duration of the active liabilities to be adopted in the calculation of future service obligations.

For sensitivity analysis, see note 29.

Assumed life expectations for a retiree age 65.

	2019	2018
	years	Years
Today		
Males	**20.8**	21.8
Females	**22.8**	23.7
In 20 years		
Males	**22.1**	23.2
Females	**24.3**	25.3

Maturity profile of DB obligations

The weighted average duration of the DB obligation for future service obligations of the scheme is 24 years and 14 years for past service obligations.

28 Financial risk management

Our activities expose us to a variety of financial risks including currency risk, interest rate risk, credit risk, capital risk and liquidity risk. Our risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential volatility of financial performance from these risks. We use financial instruments, including derivative financial instruments, to manage risks of this type.

28 Financial risk management (continued)

This note describes our approach to managing risk, including an analysis of assets and liabilities by currency type and an analysis of interest rate category for our net debt. We are required by accounting standards to also include a number of specific disclosures, (such as a maturity analysis of contractual undiscounted cash flows) and have included these requirements below.

Risk management related to financing activities is carried out by a central treasury department under policies approved by the Finance Committee of the Board of its main operating Group, Cadent Gas Limited. The objective of the treasury department is to manage funding and liquidity requirements, including managing associated financial risks, to within acceptable boundaries. The Finance Committee provides written principles for overall risk management, as well as written policies covering specific areas such as foreign exchange risk, interest rate risk, credit risk, liquidity risk, use of derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity.

We have exposure to the following risks, which are described in more detail below:

- Credit risk;
- Liquidity risk;
- Interest rate risk;
- Currency risk; and
- Capital risk.

(a) Credit risk

We are exposed to the risk of loss resulting from counterparties' default on their commitments including failure to pay or make a delivery on a contract. This risk is inherent in our commercial business activities. We are exposed to credit risk on our cash and cash equivalents, derivative financial instruments, deposits with banks and financial institutions, as well as credit exposures to customers, including outstanding receivables and committed transactions.

The carrying amount of financial assets and loss allowance are as follows:

For year ended 31st March 2019

	Notes	Gross carrying amount £m	Loss allowance £m	Net carrying amount £m
Derivative financial assets	18	8	-	8
Trade debtors	17	19	(3)	16
Amounts owed by fellow subsidiary company	17	-	-	-
Accrued income	17	166	-	166
Current asset investments	19	339	-	339

For year ended 31st March 2018

	Notes	Gross carrying amount £m	Loss allowance £m	Net carrying amount £m
Derivative financial assets	18	18	-	18
Trade debtors	17	31	(4)	27
Amounts owed by fellow subsidiary company	17	-	-	-
Accrued income	17	161	-	161
Current asset investments	19	161	-	161

28 Financial risk management (continued)

(a) Credit risk (continued)

Counterparty credit risk
Counterparty risk arises from the investment of surplus funds and from the use of derivative instruments. Our limits are managed by the central treasury department of Cadent Gas Limited.

As at 31 March 2019, we had exposure to various financial institutions. In accordance with our treasury policies, counterparty credit exposure utilisations are monitored daily against the counterparty credit limits. Counterparty credit ratings and market conditions are reviewed continually with limits being revised and utilisation adjusted, if appropriate. Derivative financial assets are only entered into with banks with credit rating A- or higher Standard & Poor's ('S&P'), which should reduce the likelihood of significant loses. Management does not expect any significant losses from non performance by these counterparties.

Customer credit risk
The Group's principal commercial exposure relates to income from shippers which is governed by the credit rules within the Uniform Network Code. These set out the level of credit relative to the RAV for each credit rating. The Group minimises customer credit risk by ensuring all customers can adequately demonstrate the ability to pay debts as they fall due. These include company credit rating, letter of credit from a financial institution, parent company guarantee, independent assessment, payment history allowance and advanced cash deposits.

Collection activities are monitored on a daily basis and late payment will result in sanctions being placed on the relevant accounts. The utilisation of credit limits is regularly monitored and collateral is collected against these accounts when necessary. Management does not expect any significant losses of receivables that have not been provided for as shown in note 17.

	2019 Total £m	2018 Total £m
Accrued income	166	161
Collateral held	(17)	(14)
Exposure net of collateral	149	147

Offsetting financial assets and liabilities
The following tables set out financial assets and liabilities which are subject to offset and to enforceable master netting arrangements or similar agreements. The tables show the amounts which are offset and reported net in the statement of financial position. Amounts which cannot be offset under IFRS, but which could be settled net under terms of master netting agreements if certain conditions arise, and with collateral received or pledged, are shown to present Cadent Gas's net exposure.

Financial assets and liabilities on different transactions are only reported net if the transactions are with the same counterparty, a legal right of offset exists and the cash flows are intended to be settled on a net basis.

Amounts which do not meet the criteria for offsetting on the statement of financial position but could be settled net in certain circumstances principally relate to derivative transactions under ISDA (International Swaps and Derivatives Association) agreements where each party has the option to settle amounts on a net basis in the event of default of the other party.

Cadent Gas has similar arrangements in relation to bank account balances and bank overdrafts; and trade payables and trade receivables which are subject to general terms and conditions. However, these balances are immaterial.

28 Financial risk management (continued)

(a) Credit risk (continued)

As at 31 March 2019	**Gross carrying amounts £m**	**Gross amounts offset £m**	**Net amount presented in statement of financial position £m**	**Financial instruments £m**	**Cash collateral received/ pledged £m**	**Net amount £m**
Assets						
Derivative financial instruments	8	-	8	-	-	8
Liabilities						
Derivative financial instruments	(38)	-	(38)	-	-	(38)
Total at 31 March 2019	**(30)**	**-**	**(30)**	**-**	**-**	**(30)**

As at 31 March 2018	Gross carrying amounts £m	Gross amounts offset £m	Net amount presented in statement of financial position £m	Financial instruments £m	Cash collateral received/ pledged £m	Net amount £m
Assets						
Derivative financial instruments	18	-	18	-	-	18
Liabilities						
Derivative financial instruments	(12)	-	(2)	-	-	(12)
Total at 31 March 2018	6	-	6	-	-	6

28 Financial risk management (continued)

(b) Liquidity risk

We determine our liquidity requirements by the use of both short-term and long-term cash flow forecasts. These forecasts are supplemented by a financial headroom analysis which is used to assess funding adequacy for at least a 24 month period and maintain adequate liquidity for a continuous 12 month period.

We believe our contractual obligations, including those shown in capital and other commitments in note 26 can be met from existing cash and investments, operating cash flows and internal or external financing that we reasonably expect to be able to secure in the future, together with the use of committed facilities if required.

Our debt agreements and banking facilities contain covenants, including those relating to the periodic and timely provision of financial information by the issuing entity, and financial covenants such as maintaining current rating levels. Failure to comply with these covenants, or to obtain waivers of these requirements, could in some cases trigger a right, at the lender's discretion, to require repayment of some of our debt, and may restrict our ability to draw upon our facilities to access the capital markets.

The following is an analysis of the contractual undiscounted cash flows payable under financial liabilities and derivative assets and liabilities as at the reporting date:

	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 3 years £m	Due 3 years and beyond £m	Total £m
As at 31 March 2019					
Non-derivative financial instruments					
Borrowings	-	-	(1,264)	(9,207)	(10,471)
Interest on payments on borrowings (i)	(240)	(242)	(236)	(2,553)	(3,271)
Other non-interest bearing liabilities	(560)	-	-	-	(560)
Derivative financial instruments					
Derivative contracts - receipts	24	24	25	1,052	1,125
Derivative contracts - payments	(20)	(20)	(20)	(1,149)	(1,209)
Total at 31 March 2019	**(796)**	**(238)**	**(1,495)**	**(11,857)**	**(14,386)**

i) The interest on borrowings is calculated based on borrowings held at 31 March without taking account of future issues. Floating rate interest is estimated using a forward interest rate curve as at 31 March. Payments are included on the basis of the earliest date on which the company can be required to settle.

28 Financial risk management (continued)

(b) Liquidity risk (continued)

	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 3 years £m	Due 3 years and beyond £m	Total £m
As at 31 March 2018					
Non-derivative financial instruments					
Borrowings	-	(1,046)	-	(9,042)	(10,088)
Interest on payments on borrowings (i)	(186)	(179)	(180)	(2,245)	(2,790)
Other non-interest bearing liabilities	(422)	-	-	-	(422)
Derivative financial instruments					
Derivative contracts - receipts	17	18	19	800	854
Derivative contracts - payments	(13)	(13)	(13)	(868)	(907)
Total at 31 March 2018	(604)	(1,220)	(174)	(11,355)	(13,353)

i) The interest on borrowings is calculated based on borrowings held at 31 March without taking account of future issues. Floating rate interest is estimated using a forward interest rate curve as at 31 March. Payments are included on the basis of the earliest date on which the company can be required to settle.

ii) The 2018 comparative has been updated to disclose gross derivative payments and receipts.

(c) Interest rate risk

Interest rate risk arises from our long-term borrowings. Borrowings issued at variable rates expose us to cash flow interest rate risk, partially offset by cash held at variable rates. Borrowings issued at fixed rates expose us to fair value interest rate risk.

Our interest rate risk management policy is to seek to minimise total financing costs (being interest costs and changes in the market value of debt) subject to constraints. We do this by using fixed and floating rate debt and derivative financial instruments including interest rate swaps, swaptions and forward rate agreements.

We hold some borrowings on issue that are inflation linked. We believe that these provide a partial economic offset to the inflation risk associated with our UK inflation linked revenues.

The table in note 22 (borrowings) sets out the carrying amount, by contractual maturity, of borrowings that are exposed to interest rate risk before taking into account interest rate swaps.

28 Financial risk management (continued)

(c) Interest rate risk (continued)

As at 31 March 2019, net debt was managed for the Group using derivative instruments to hedge interest rate risk as follows:

	Fixed rate £m	**Floating rate £m**	**RPI £m**	**Other (i)**	**Total £m**
As at 31 March 2019					
Financial investments (i)	-	351	-	-	351
Borrowings	(6,675)	(1,095)	(1,766)	(6)	(9,542)
Pre-derivative position	(6,675)	(744)	(1,766)	(6)	(9,191)
Derivative effect	5	400	(435)	-	(30)
Net debt position (ii)	**(6,670)**	**(344)**	**(2,201)**	**(6)**	**(9,221)**

i) Represents financial instruments which are not directly affected by interest rate risk, including investments in equity or other non-interest bearing instruments.

ii) The impact of 2018/19 short-dated interest rate derivatives is included.

As at 31 March 2018, net debt was managed for the Group using derivative instruments to hedge interest rate risk as follows:

	Fixed rate £m	Floating rate £m	RPI £m	Other (i)	Total £m
As at 31 March 2018					
Financial investments (i)	-	181	-	-	181
Borrowings	(5,283)	(2,132)	(1,742)	(6)	(9,163)
Pre-derivative position	(5,283)	(1,951)	(1,742)	(6)	(8,982)
Derivative effect	6	-	-	-	6
Net debt position (ii)	(5,277)	(1,951)	(1,742)	(6)	(8,976)

i) Represents financial instruments which are not directly affected by interest rate risk, including investments in equity or other non-interest bearing instruments.

ii) The impact of 2017/18 short-dated interest rate derivatives is included.

(d) Currency risk

We are exposed to foreign exchange risk arising from non-sterling future commercial transactions and non-sterling recognised assets and liabilities.

Our policy for managing foreign exchange risk is to hedge contractually committed foreign currency cash flows over a prescribed minimum size. Where foreign currency cash forecasts are less certain, our policy is to hedge a proportion of the cash flows based on the probability of those cash flows occurring. Instruments used to manage foreign exchange transaction risk include foreign exchange forward contracts and foreign exchange swaps.

As at 31 March 2019, derivative financial instruments were used to manage foreign currency risk as follows:

	Sterling £m	**Euro £m**	**Japanese Yen £m**	**Dollar £m**	**Total £m**
As at 31 March 2019					
Financial investments	351	-	-	-	351
Borrowings	(8,644)	(636)	(69)	(193)	(9,542)
Pre-derivative position	(8,293)	(636)	(69)	(193)	(9,191)
Derivative effect	(928)	636	69	193	(30)
Net debt position	**(9,221)**	**-**	**-**	**-**	**(9,221)**

28 Financial risk management (continued)

(d) Currency risk (continued)

As at 31 March 2018, derivative financial instruments were used to manage foreign currency risk as follows:

	Sterling £m	Euro £m	Japanese Yen £m	Dollar £m	Total £m
As at 31 March 2018					
Financial investments	181	-	-	-	181
Borrowings	(8,481)	(646)	-	(36)	(9,163)
Pre-derivative position	(8,300)	(646)	-	(36)	(8,982)
Derivative effect	(676)	646	-	36	6
Net debt position	(8,976)	-	-	-	(8,876)

Effect of hedge accounting on the financial position and performance

a) The impact of hedging instruments designated in a hedge relationship as at 31st March 2019 are as follows:

	Notional amount (GBP m)	Carrying amount of the hedging instrument		Fair value changes	Line item in consolidated statement of financial position where hedging instrument is reported
		Assets	Liabilities		
Cash flow hedges					
Cross currency interest rate swaps	895	8	(3)	(7)	Derivative financial assets Derivative financial liabilities

The impact of hedging instruments designated in a hedge relationship as at 31st March 2018 are as follows:

	Notional amount (GBP m)	Carrying amount of the hedging instrument		Fair value changes	Line item in consolidated statement of financial position where hedging instrument is reported
		Assets	Liabilities		
Cash flow hedges					
Cross currency interest rate swaps	676	15	(3)	21	Derivative financial assets Derivative financial liabilities

b) The impact of hedged items designated in a hedge relationship as at 31st March 2019 are as follows:

	Carrying amount of the hedged item (GBP m)		Fair value changes	Line item in consolidated statement of financial position where hedging instrument is reported	Cash flow hedge reserve	Cost of hedging reserve
	Assets	Liabilities				
Cash flow hedges						
Non GBP denominated debt	-	(898)	5	Borrowings	8	(1)

28 Financial risk management (continued)

(d) Currency risk (continued)

The impact of hedged items designated in a hedge relationship as at 31st March 2018 are as follows:

	Carrying amount of the hedged item (GBP m)		Fair value changes	Line item in consolidated statement of financial position where hedging instrument is reported	Cash flow hedge reserve	Cost of hedging reserve
	Assets	Liabilities				
Cash flow hedges						
Non GBP denominated debt	-	(682)	(17)	Borrowings	12	-

c) The Impact of the hedging relationships on the consolidated income statement and other comprehensive income

The above hedging relationships affected the consolidated income statements for year ended March 2019 are as follows:

	Change in value of hedging instrument recognised in OCI	Hedge ineffectiveness recognised in consolidated income statement	Line item in consolidated income statement where the hedge ineffectiveness is reported	Amount reclassified from cash flow hedge reserve to consolidated income statement	Line item in the consolidated income statement
Cash flow hedges					
Interest rate risk & FX risk	(5)	4	Exceptional items and remeasurements	(9)	Finance costs

The above hedging relationships affected the consolidated income statements for year ended March 2018 are as follows:

	Change in value of hedging instrument recognised in OCI	Hedge ineffectiveness recognised in consolidated income statement	Line item in consolidated income statement where the hedge ineffectiveness is reported	Amount reclassified from cash flow hedge reserve to consolidated income statement	Line item in the consolidated income statement
Cash flow hedges					
Interest rate risk & FX risk	12	-	Exceptional items and remeasurements	(8)	Finance costs

28 Financial risk management (continued)

(e) Capital risk management

The capital structure of the Group consists of shareholders' equity, as disclosed in the consolidated statement of changes in equity, and net debt (note 25). Our objectives when managing capital are: to safeguard our ability to continue as a going concern, to remain within regulatory constraints of our regulated operating company and to maintain an efficient mix of debt and equity funding thus achieving an optimal capital structure and cost of capital. We regularly review and manage the capital structure as appropriate in order to achieve these objectives.

Maintaining appropriate credit ratings for our main regulated operating company, Cadent Gas Limited, is an important aspect of our capital risk management strategy and balance sheet efficiency. We monitor our balance sheet efficiency by regulatory asset value (RAV) gearing calculated as adjusted net debt (statutory net debt adjusted for unamortised debt fees, unamortised fair value adjustments, accrued interest and derivatives) expressed as a percentage of RAV, which indicates the level of debt employed to fund our regulated business. It is compared with the level of RAV gearing indicated by Ofgem as being appropriate for our business, at around 62.5 - 65%. The RAV gearing ratio at the Cadent Gas Limited level was 31 March 2019 was 62% (2018: 62%).

(f) Fair value analysis

The financial instruments included on the statement of financial position are measured at fair value. These fair values can be categorised into hierarchy levels that are representative of the inputs used in measuring the fair value. The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used.

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
As at 31 March 2019				
Assets				
Available-for-sale investments	351	-	-	351
Derivative financial instruments	-	8	-	8
Liabilities				
Derivative financial instruments	-	(38)	-	(38)
Total	**351**	**(30)**	**-**	**321**

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
As at 31 March 2018				
Assets				
Available-for-sale investments	181	-	-	181
Derivative financial instruments	-	18	-	18
Liabilities				
Derivative financial instruments	-	(12)	-	(12)
Total	**181**	**(6)**	**-**	**187**

Level 1: Financial instruments with quoted prices for identical instruments in active markets.
Level 2: Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are based directly or indirectly on observable market data.
Level 3: Financial instruments valued using valuation techniques where one or more significant inputs are based on unobservable market data.

29 Sensitivity analysis

In order to give a clearer picture of the impact on our results or financial position of potential changes in significant estimates and assumptions, the following sensitivities are presented. The effects provided are not necessarily indicative of the actual effects that would be experienced because our actual exposures are constantly changing.

The sensitivities in the table below show the potential impact on net assets for a range of different variables, each of which have been considered in isolation (i.e. with all other variables remaining constant). There are a number of these sensitivities which are mutually exclusive and therefore if one were to happen, another would not, meaning a total showing how sensitive our results are to these external factors is not meaningful.

We are further required to show additional sensitivity analysis for changes in interest and inflation rates and these are shown separately in the subsequent table due to the additional assumptions that are made in order to produce meaningful sensitivity disclosures.

The sensitivities included in the table below all have an equal and opposite effect if the sensitivity increases or decreases by the same amount unless otherwise stated. For example a 10% increase in unbilled revenue at 31 March 2019 would result in an increase in the income statement of £17 million and a 10% decrease in unbilled revenue would have the equal but opposite effect.

	2019		2018	
	Income Statement £m	**Net Assets £m**	**Income Statement £m**	**Net Assets £m**
One year average increase in useful economic lives (pre-tax)				
Depreciation charge on property, plant and equipment	14	14	11	11
Amortisation charge on intangible assets	5	5	5	5
Environmental provision change in discount rate of 0.5%	5	5	4	4
Environmental provision change in undiscounted cash flow of 10%	4	4	4	4
Assets and liabilities carried at fair value change of 10% (pre-tax)				
Derivative financial instruments (i)	3	3	1	1
Goodwill impairment				
RPI change of 0.5%	726	726	1,140	1,140
Pre tax WACC change of 0.5%	874	874	810	810
Terminal value change of 0.05 multiple	159	159	-	-
Regulatory WACC 0.5%	316	316	571	571
Pensions and other post-retirement benefits (ii) (pre-tax)				
Discount rate change of 0.5% (iii)	2	415	3	454
RPI rate change of 0.5% (iv)	2	397	2	437
Long-term rate of increase in salaries change of 0.5%	-	14	-	18
Change of one year to life expectancy at age 65	1	261	1	254
Unbilled revenue at 31 March change of 10% (post-tax)	17	17	16	16
No hedge accounting for our derivative financial instruments (post tax)	6	-	13	-

i) The effect of a 10% change in fair value assumes no hedge accounting.

29 Sensitivity analysis (continued)

ii) The changes shown are a change in the annual pension or other post-retirement benefit service charge and change in the defined benefit obligations.
iii) A change in the discount is likely to occur as a result of changes in bond yields and as such would be expected to be offset to a significant degree by a change in the value of the bond assets held by the plans.
iv) The projected impact resulting from a change in RPI reflects the underlying effect on pensions in payment, pensions in deferment and resultant increases in salary assumptions.

	2019		2018	
	Income statement £m	Net assets £m	Income statement £m	Net assets £m
Financial risk (post-tax)				
UK RPI rate change of 0.5%	9	-	4	-
UK interest rate change of 0.5%	3	-	6	-

Financial instruments assumptions
Our financial instruments are sensitive to changes in market variables, being UK interest rates and the UK RPI. The changes in market variables impacts the valuation of our borrowings, deposits and derivative financial instruments. The analysis illustrates the sensitivity of our financial instruments to the changes in market variables.

The following main assumptions were made in calculating the sensitivity analysis:
- the amount of net debt, the ratio of fixed to floating interest rates of the debt and derivatives portfolio and the proportion of financial instruments in foreign currencies are all constant and on the basis of the hedge designations in place at 31 March 2019;
- the statement of financial position sensitivity to interest rates relates only to derivative financial instruments and available-for-sale investments, as debt and other deposits are carried at amortised cost and so their carrying value does not change as interest rates move;
- the sensitivity of accrued interest to movements in interest rates is calculated on net floating rate exposures on debt, deposits and derivative instruments; and
- changes in the carrying value of derivatives from movements in interest rates of designated cash flow hedges are assumed to be recorded fully within equity.

30 Contingent liabilities

(a) Environmental claims

The environmental provision (see note 23) has been set up to deal with the costs of statutory decontamination of Cadent Gas' UK old gas-manufacturing sites and Cadent Services' gas sites. Other claims have arisen from time to time, however none of these have been significant. It is not possible to determine the level of such future claims however, based upon experience, the Directors do not consider a provision necessary.

(b) Litigation

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

30 Contingent liabilities (continued)

(c) Health and Safety Executive investigation

In early 2018, Cadent identified that a number of high-rise buildings were not on our records and therefore were not part of the 10-year rolling survey programme for long life assets. Cadent immediately implemented a survey recovery programme to resolve the issue as quickly and effectively as possible. The recovery programme was completed on 24 September 2018. Cadent informed the Health and Safety Executive who opened an investigation into this issue. Cadent worked with the Health and Safety Executive as they progressed their investigation. A decision is awaited. The investigation could result in a financial penalty against Cadent in accordance with the guidelines that apply.

(d) Guarantees and letters of credit

Group undertakings have entered into bonds and guarantees in the normal course of business. No liability is expected to arise in respect of either bonds or guarantees.

31 Related party transactions

A related party is a company or individual who also has an interest in us, for example a company that provides a service to us with a director who holds a controlling stake in that company and who is also a Director of Quadgas MidCo Limited. The related parties identified include the immediate parent, ultimate parent, fellow subsidiaries, associated undertakings, investments and key management personnel.

	2019 £m	2018 £m
Income:		
Goods and services supplied to associates	**1**	1
Goods and services supplied to other related parties	**45**	43
	46	44
Expenditure:		
Services rendered from associates	**12**	18
Services rendered from other related parties	**202**	217
Corporate services received from other related parties	**5**	5
	219	240
Outstanding balances at 31 March in respect of income and expenditure:		
Amounts receivable from associates	**-**	-
Amounts receivable from other related parties	**8**	18
Amounts payable to associates	**1**	2
Amounts payable to other related parties	**26**	26

Related party transactions were made on terms equivalent to those that prevail in arm's length transactions. Amounts receivable from or payable to related parties in respect of sales and expenditure are ordinarily settled one month in arrears. The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received.

Amounts of £Nil have been provided at 31 March 2019 and recognised as an expense (2018: £39,000) during the period in respect of bad or doubtful debts for related party transactions.

Details of key management compensation are provided in note 7.

32 Subsequent events

To ensure a sustainable future for our customer and business, Cadent announced on the 13 May 2019 that it was offering a voluntary redundancy programme for all managers and staff. The cost of this programme cannot be determined with certainty at this stage as the programme is subject to employee consultation with the period of consultation running to 26 June 2019. Management's current best estimate is a cost between £15 - £20m.

33 Ultimate parent company

The ultimate parent and controlling company is Quadgas Holdings TopCo Limited and the immediate parent company is Quadgas PledgeCo Limited. The largest and smallest Group which includes the company and for which consolidated financial statements are prepared are headed by Quadgas Holdings TopCo Limited and Quadgas HoldCo Limited respectively. Quadgas Holdings TopCo Limited is registered in Jersey and Quadgas HoldCo Limited is registered in England and Wales.

Copies of Quadgas HoldCo Limited's consolidated financial statements can be obtained from the Company Secretary, Quadgas HoldCo Limited, Ashbrook Court, Prologis Park, Central Boulevard, Coventry, CV7 8PE.

Copies of Quadgas Holdings TopCo Limited's consolidated financial statements can be obtained from the Registered office, Quadgas Holdings TopCo Limited, 3rd Floor 37 Esplanade, St. Helier, Jersey JE1 1AD

34 Subsidiary undertakings

The list below contains all subsidiaries included within the Quadgas MidCo Group.

Name of subsidiary	% Holding	Principal activity	Country of incorporation
Cadent Gas Limited	100	Gas Distribution	England and Wales
Cadent Finance Plc *	100	Provision of long term finance	England and Wales
Cadent Services Limited	100	Provision of services (including property management)	England and Wales
Quadgas Finance Plc	100	Provision of long term finance	England and Wales

The registered address for all subsidiaries is Ashbrook Court, Prologis Business Park, Central Boulevard, Coventry, CV7 8PE.

* Indirect holding

Quadgas MidCo Limited
Company Statement of Financial Position
As at 31 March 2019

	Notes	**2019 £m**	2018 £m
Non-current assets			
Investments	6	**6,296**	7,747
Total non-current assets		**6,296**	7,747
Current assets			
Debtors	7	**40**	46
Cash at bank and in hand		**7**	**11**
Current asset investments	9	**7**	-
Total current assets		**54**	57
Total assets		**6,350**	7,804
Current liabilities			
Borrowings	12	**(2)**	(2)
Derivative financial liabilities	8	**-**	(3)
Creditors: amounts due within one year	10	**(12)**	(5)
Total current liabilities		**(14)**	(10)
Non-current liabilities			
Borrowings	12	**(898)**	(1,527)
Creditors: amounts due after more than one year	11	**(1,872)**	(1,230)
Total non-current liabilities		**(2,770)**	(2,757)
Total liabilities		**(2,784)**	(2,767)
Net assets		**3,566**	5,037
Equity			
Share capital	13	**1**	1
Retained earnings		**3,566**	5,037
Cash flow hedge reserve		**(1)**	(1)
Cost of hedging reserve		**-**	-
Total equity		**3,566**	5,037

The company has elected to take the exemption under Section 408 of the Companies Act 2006 from preparing the parent company profit and loss account. The profit for the year is disclosed in the statement of changes in equity.

The notes on pages 83 to 94 are an integral part of the financial statements.

The financial statements on pages 81 to 94 were approved by the Board of Directors on 27 June 2019 and signed on its behalf by:

M W Braithwaite
Director, Quadgas MidCo Limited
Company registration number: 10615396

Quadgas MidCo Limited
Company Statement of Changes in Equity
For the year ended 31 March 2019

	Share capital £m	Share premium account £m	Cash flow hedge reserve £m	Cost of Hedging reserve £m	Retained earnings £m	Total £m
At 1 April 2018	1	-	(1)	-	5,037	5,037
Changed due to adoption of IFRS 9	-	-	-	-	-	-
At 1 April 2018 (restated)	1	-	(1)	-	5,037	5,037
Loss for the year	-	-	-	-	(1,131)	(1,131)
Other comprehensive income for the year	-	-	-	-	-	-
Amortisation of cost of hedging reserve	-	-	-	-	-	-
Total comprehensive (loss) / income for the year	-	-	-	-	(1,131)	(1,131)
Equity Dividend	-	-	-	-	(340)	(340)
At 31 March 2019	**1**	**-**	**(1)**	**-**	**3,566**	**3,566**

	Share capital £m	Share premium account £m	Cash flow hedge reserve £m	Cost of Hedging reserve £m	Retained earnings £m	Total £m
At 1 April 2017	4,928	-	-	-	(10)	4,918
Profit for the year	-	-	-	-	312	312
Other comprehensive income for the year	-	-	(1)	-	-	(1)
Total comprehensive (loss) / income for the year	-	-	(1)	-	312	311
Issue of share capital	177	-	-	-	-	177
Capital reduction	(5,104)	-	-	-	5,104	-
Equity Dividend	-	-	-	-	(369)	(369)
At 31 March 2018	**1**	**-**	**(1)**	**-**	**5,037**	**5,037**

The cash flow hedge reserve on cross-currency interest rate swap contracts will be continuously transferred to the income statement until the borrowings are repaid.

1 Summary of significant accounting policies

We are required to include the stand-alone balance sheet of our parent company, Quadgas MidCo Limited, under the Companies Act 2006, and the statement of changes in equity under Financial Reporting Standard 101, "The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland" ("FRS 101"). The following disclosures provide additional information to the stakeholders.

Quadgas MidCo Limited is a private company and is incorporated and domiciled in the United Kingdom and is registered in England and Wales. The address of its registered office is Ashbrook Court, Prologis Business Park, Central Boulevard, Coventry, CV7 8PE.

The principal accounting policies applied in the preparation of these financial statements are set out as below. These policies have been consistently applied to the current period presented, unless otherwise stated.

(a) Basis of preparation

The financial statements for the company have been prepared on the going concern basis under the historical cost convention modified to include certain items at fair value.
Items included in the financial statements are measured using the currency of the primary economic environment in which the company operates (the 'functional currency'). The financial statements are presented in pounds sterling which is also the company's functional currency.

(i) Parent company financial statements

The company meets the definition of a qualifying entity under FRS 100 (Financial Reporting Standard 100) issued by the Financial Reporting Council.

The financial statements have therefore been prepared in accordance with FRS 101 (Financial Reporting Standard 101) 'Reduced Disclosure Framework' as issued by the Financial Reporting Council.

As permitted by FRS 101, the company has taken advantage of the disclosure exemptions available under that standard in relation to business combinations, non-current assets held for sale, financial instruments, capital management, presentation of a cash-flow statement, standards not yet effective, impairment of assets and related party transactions.

Where relevant, equivalent disclosures have been presented in the Group accounts of Quadgas MidCo Limited.

The preparation of financial statements may require management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities and the reported amounts of turnover and expenses during the reporting period. Actual results could differ from these estimates.

The key accounting estimate is in respect of the fair value of derivative financial instruments which are calculated by discounting future cash flows. Discount rates are derived from yield curves based on quoted interest rates and are adjusted for credit risk, which is estimated based on market observations.

1 Summary of significant accounting policies (continued)

(b) New IFRS accounting standards and interpretations

The company has applied IFRS 9 'Financial instruments' for the first time during the period coming into effect on 1 April 2018. The nature and effect of this change is disclosed below.

IFRS 9 introduces new requirements for the classification and measurement of financial assets and financial liabilities, impairment of financial assets, and rules for hedge accounting. Details for these new these new requirements as well as their impact on the financial statements are described below.

Classification of financial assets

IFRS 9 requires the use of two criteria to determine the classification of financial assets: the entity's business model for the financial assets and the contractual cash flow characteristics of the financial assets. The standard goes on to identify three categories of financial assets - amortised cost; fair value through profit or loss (FVTPL); and fair value through other comprehensive income (FVOCI).

There were no reclassifications required at 31 March 2018.

Impairment

IFRS 9 mandates the use of an expected credit loss model to calculate impairment losses rather than an incurred loss model. Under IFRS 9, it is not necessary for a credit event to have occurred before credit losses are recognised. The new impairment model requires the company to recognise expected credit losses for intercompany receivables. The expected credit loss model is discussed further in section 1(e) financial instruments.

The company has intercompany balances of £36m (2018: £40m), under IFRS 9, the company is required to calculate expected credit losses on all financial assets, including intercompany loans. The probability of default and loss given default has assumed to be low by management as all amounts due from subsidiary undertakings relate to investment grade entities or related companies therefore no impairment is deemed appropriate.

Hedge accounting

IFRS 9 contains new requirements on the application of hedge accounting. The new requirements look to align hedge accounting more closely with entities' risk management activities by increasing the eligibility of both hedged items and hedging instruments and introducing a more principles-based approach to assessing hedge effectiveness.

IFRS 9 introduces an optional treatment for cross currency swaps designated in hedge relationships, whereby the currency basis element can be bifurcated with changes in fair value recorded in other comprehensive income ("OCI"). The company has elected to apply this accounting treatment.

There is no impact on the company's accounting for financial liabilities, as the new requirements only affect the accounting for financial liabilities that are designated at fair value through profit and loss and the company does not have any such liabilities. The derecognition rules have been transferred from IAS 39 and have not been changed.

In summary, the following adjustments were made to the amounts at the date of initial application (1 April 2018):

	IAS 39 carrying amount 31 March 2018* £m	Adjustments relating to IFRS 9 transition £m	IFRS 9 carrying amount 1 April 2018* £m
Cash flow hedge reserve	(1)	-	(1)
Cost of hedging reserve	-	-	-

1 Summary of significant accounting policies (continued)

(c) Fixed asset investments

Investments in Group undertakings are held at cost less accumulated impairment losses.

Impairment reviews are carried out if there is some indication that impairment may have occurred, or where otherwise required to ensure that investments are not carried above their estimated recoverable amounts. Impairments are recognised in the income statement, and, where material, are disclosed separately. Impairment reversals are recognised when, in management's opinion, the reversal is permanent.

Impairments of investments are calculated as the difference between the carrying value of the investment and its recoverable amounts. Recoverable amount is defined as the higher of net realisable value or estimated value in use at the date the impairment review is undertaken.

(d) Impairment of fixed assets

Impairment reviews are carried out if there is some indication that impairment may have occurred, or where otherwise required to ensure that fixed assets are not carried above their estimated recoverable amounts. Impairments are recognised in the income statement, and, where material, are disclosed as exceptional. Impairment reversals are recognised when, in management's opinion, the reversal is permanent.

Impairments of fixed assets are calculated as the difference between the carrying value of the net assets of income generating units, including where appropriate, investments, and their recoverable amounts. Recoverable amount is defined as the higher of net realisable value or estimated value in use at the date the impairment review is undertaken. Net realisable value represents the amount that can be generated through the sale of assets. Value in use represents the present value of expected future cash flows discounted on a pre-tax basis, using the estimated cost of capital of the income generating unit.

(e) Financial instruments

Initial recognition
Financial assets, liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

1 Summary of significant accounting policies (continued)

(e) Financial instruments (continued)

Classification and measurement
Financial instruments are classified at inception into one of the following categories which then determines the subsequent measurement methodology:

Financial assets are classified into one of the following three categories:

- financial assets at amortised cost; and
- financial assets at fair value through other comprehensive income (FVTOCI); and
- financial assets at fair value through profit or loss (FVTPL).

Financial liabilities are classified into one of the following two categories

- financial liabilities at amortised cost; and
- financial liabilities at fair value through profit and loss (FVTPL).

Loans receivable are carried at amortised cost using the effective interest method less any allowance for estimated impairments. A provision is established for impairments when there is objective evidence that the Group will not be able to collect all amounts due under the original terms of the loan. Interest income, together with losses when the loans are impaired, is recognised using the effective interest method in the income statement.

Borrowings, which include interest-bearing loans, are recorded at their initial fair value which normally reflects the proceeds received, net of direct issue costs less any repayments. Subsequently these are stated at amortised cost, using the effective interest method. Any difference between proceeds and the redemption value is recognised over the term of the borrowing in the income statement using the effective interest method.

Accretion on inflation linked borrowings is accounted for on an accrual basis to the income statement, and are added to the carrying value of the debt instrument to the extent that they are not settled in the period in which they arise.

Derivative financial instruments ('derivatives') are recorded at fair value. Where the fair value of a derivative is positive, it is carried as a derivative asset and where negative, as a liability.

Assets and liabilities on different transactions are only netted if the transactions are with the same counterparty, a legal right of set off exists and the cash flows are intended to be settled on a net basis. Gains and losses arising from changes in fair value are included in the income statement in the period they arise, unless hedge accounting applies.

The fair value of financial derivatives is calculated by discounting all future cash flows by the market yield curve at the reporting date and adjusting for own and counterparty credit. The market yield curve for each currency is obtained from external sources for interest and foreign exchange rates.

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

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

1 Summary of significant accounting policies (continued)

(e) Financial instruments (continued)

Derecognition

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income and accumulated in equity is recognised in profit or loss.

Impairment of financial assets

The Group recognises loss allowances for expected credit losses (ECL) on financial instruments that are not measured at FVTPL, namely:

- trade receivables; and
- loan receivables; and
- other receivables.

The Group measures the loss allowances at an amount equal to the lifetime expected credit loss. The way this is calculated is based on the applied impairment methodology, as described below:

Stage 1: For financial assets where there has not been a significant increase in credit risk since initial recognition, and were not credit impaired on recognition, the Group recognises a loss allowance based on the 12 month expected credit loss.

Stage 2: For financial assets where there has been a significant increase in credit risk since initial recognition, and were not credit impaired, the Group recognises a loss allowance for lifetime expected credit loss.

Stage 3: For financial assets which are credit impaired, the Group recognises the lifetime expected credit loss.

A significant increase in credit risk as a result of any change in circumstances specific to the counterparty or to the wider economic environment whereby the risk of default could be said to have been significantly increased within reasonable thresholds.

Evidence that the financial asset is credit impaired includes the following:

- significant financial difficulties of the counterparty; or
- a breach of contract such as default or past due event; or
- the restructuring of the loan or advance by the Group that the Group would not consider otherwise; or
- it is probably that the counterparty will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for an associated security because of financial difficulties.

1 Summary of significant accounting policies (continued)

(f) Tax

Current tax for the current period is provided at the amount expected to be paid or recovered using the tax rates and tax laws enacted or substantively enacted by the balance sheet date. Deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or the right to pay less tax, at a future date, at tax rates expected to apply when the timing differences reversed, based on tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements.

Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

(g) Dividends

Dividend income is recognised when the right to receive payment is established. Dividend distributions to the company's shareholders are recognised as a liability in the company's financial statements in the period in which the dividends are approved by the company's shareholders.

(h) Cash and cash equivalents

For the purpose of presentation in the statement of cash flows, cash and cash equivalents includes cash on hand, deposits held at call with financial institutions, other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities in the balance sheet.

2 Critical accounting judgements and estimation uncertainty

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

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

Areas of judgement that have the most significant effect on the amounts recognised in the financial statements are as follows:

- The impairment of investments – note 6.

Key sources of estimation uncertainty that have significant risk of causing material adjustment to the carrying amounts of assets and liabilities in the next financial year are as follows:

- Review of carrying values of investments and calculation of impairment – note 6.

3 Auditor's remuneration

Auditor's remuneration in respect of the company is set out below:

	2019 £'000	2018 £'000
Audit services		
Audit of parent company and consolidated financial statements	**52**	**50**
Audit of subsidiary company financial statements	**36**	**35**
Other services		
Fees payable to the company's auditor for audit-related assurance services	**41**	**10**
Other non-audit services	**46**	**28**

4 Number of employees, including Directors

The average number of persons (including Executive Directors) employed by the company was Nil (2018: Nil).

5 Key management compensation

Key management comprises the Board of Directors of the company who have managerial responsibility for Quadgas MidCo Limited. Details of key management personnel compensation are provided in note 7 to the consolidated financial statements.

6 Investments

	Shares in Subsidiary Undertakings £m	Other investments £m	Total £m
Cost			
At 1 April 2018 and at 31 March 2019	7,747	-	7,747
Provision			
At 1 April 2018	-	-	-
Impairment	(1,451)	-	(1,451)
At 31 March 2019	(1,451)	-	(1,451)
Net book value			
At 31 March 2019	**6,296**	**-**	**6,296**
At 31 March 2018	7,747	-	7,747

The net carrying value of the investment held in Cadent Gas Limited and Cadent Services Limited was compared to its recoverable amount as part of the annual impairment review carried out by management.

The recoverable amount of the cash generating unit was determined from value in use calculations. The key assumptions for the value in use calculation are those regarding the underlying cash flows, discount rate, regulatory weighted average cost of capital, inflation and terminal value cashflow (see note 13 of the Quadgas MidCo Group Financial Statements for further information).

6 Investments (continued)

Management had been reviewing Ofgem announcements on RIIO-2 during the course of the year given the potential impact on the recoverable amount. On 18 December 2018, Ofgem published the RIIO-2 Sector Specific Methodology that provided firmer and more detailed guidance on the regulatory cost of capital, totex sharing factors and CPIH inflation change. On the 24 May 2019 Ofgem published its RIIO-2 Sector Specific Methodology Decision which provided an up-dated range for the regulatory cost of capital and more detail on how other amendments to regulatory mechanisms will be implemented. The value in use reduced as a result of lower return expectations set out in the Sector Specific Decision Document.

As a result, an impairment of £1,451 million was recognised in the Statement of Comprehensive Income in the year.

Carrying value comprised the investment in subsidiary undertakings

Name of subsidiary	**% Holding**	**Principal activity**	**Country of incorporation**
Quadgas Finance Plc	100	Provision of long term finance	England and Wales
Cadent Gas Limited	100	Gas Distribution	England and Wales
Cadent Services Limited	100	Provision of services (including property management)	England and Wales
Cadent Finance Plc	100 (indirect)	Provision of long term finance	England and Wales

The registered address of these investments is Ashbrook Court, Prologis Business Park, Central Boulevard, Coventry, CV7 8PE.

7 Debtors

	2019	2018
	£m	£m
Amounts falling due within one year:		
Amounts owed by subsidiary undertakings	**36**	40
Other debtors	**4**	5
Prepayments and accrued income	**-**	1
	40	46

Amounts owed by subsidiary undertakings are unsecured, interest free and repayable upon demand.

8 Derivative financial instruments

The fair values of derivative financial instruments are as follows:

		2019	
	Assets	**Liabilities**	**Total**
	£m	**£m**	**£m**
Amounts falling due within one year	**-**	**-**	**-**
Amounts falling due after more than one year	**-**	**-**	**-**
	-	**-**	**-**

8 Derivative financial instruments (continued)

	2018		
	Assets	Liabilities	Total
	£m	£m	£m
Amounts falling due within one year	-	-	-
Amounts falling due after more than one year	-	(3)	(3)
	-	(3)	(3)

For each class of derivative the notional contract amounts* are as follows:

	2019	2018
	£m	£m
Cross-currency interest rate swaps	38	38
	38	38

*The notional contract amounts of derivatives indicate the gross nominal value of transactions outstanding at the reporting date.

9 Current asset investments

	2019	2018
	£m	£m
Investments in short-term money funds	**7**	-
	7	-

10 Creditors: amounts falling due within one year

	2019	2018
	£m	£m
Amounts owed to subsidiary undertakings	**12**	1
Amounts owed to immediate parent company	**-**	4
	12	5

11 Creditors: amounts falling due after more than one year

	2019	2018
	£m	£m
Amounts owed to immediate parent company	**902**	902
Amounts owed to subsidiary undertakings	**970**	328
	1,872	1,230

Amounts due to immediate parent undertakings are unsecured, at an arm’s length interest rate of 6.8% (2018: 6.8%) and repayable on 30/04/2042.

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

Amounts owed to subsidiary undertakings reflect external debt raised by Quadgas Finance Plc and passed on to Quadgas MidCo Limited. The amounts are usually passed on to Quadgas MidCo Limited on identical terms to the amount raised in Quadgas Finance Plc. The amounts are unsecured with interest payments to 2027.

12 Borrowings

	2019 £m	2018 £m
Amounts falling due within one year		
Bank loans	**-**	2
Bonds	**2**	-
	2	2
Amounts falling due after more than one year		
Bank loans	**217**	859
Bonds	**681**	668
	898	1,527

	2019 £m	2018 £m
Total borrowings are repayable as follows:		
Less than 1 year	**2**	2
In 1-2 years	**-**	641
In 2-3 years	**217**	-
In 3-4 years	**-**	218
In 4-5 years	**-**	-
More than 5 years	**681**	668
	900	1,529

The notional amount of borrowings outstanding as at 31 March 2019 was £870m (2018: £1,516m), £899m (2018: £1,533m), including accretion.

The company's borrowings comprise fixed rate, floating rate and indexed linked debt which has been issued out of the company. The table below summarises the debt, including their fair values.

12 Borrowings (continued)

Summary of Borrowings				31-Mar-2019		
Currency	Type	Notional (inc. accretion)* £m	Rate	Maturity Date	Book value £m	Fair Value £m
Fixed Rate						
GBP	Listed	125	Fixed	31/03/2037	125	130
		125			**125**	**130**
Index Linked						
GBP	Listed	280	RPI-linked	31/03/2042	279	281
GBP	Listed	42	RPI-linked	31/03/2037	42	43
GBP	Listed	79	RPI-linked	31/03/2042	80	75
GBP	Listed	79	RPI-linked	31/03/2037	81	78
		480			**482**	**477**
Floating Rate						
GBP	Unlisted	218	LIBOR +	31/03/2022	217	222
GBP	Unlisted	76	LIBOR +	31/03/2037	76	74
		294			**293**	**296**
Overdraft		**0**			0	0
TOTAL		**899**			**900**	**903**

* Index-linked debt notional is the accreted value

Most of the debt issued in Quadgas MidCo was issued on 31 March 2017 and guaranteed by Quadgas Pledgeco Limited, its parent company. On 28 September 2018, the company repaid early the £646m Term A facility due 2020.

As of 31 March 2019, the fair value of all Quadgas MidCo Limited debt was £903m (2018: £1,539m). Where market values were available, the fair value of borrowings (Level 1) was £Nil (2018; £Nil). Where market values were not available, the fair value of borrowings (Level 2) was £903m (2018: £1,539m).

None of the company's borrowings are secured by charges over assets of the company.

13 Share capital

Allotted, called up and fully paid	**2019 £m**	2018 £m
5,105,581,781 ordinary shares of £0.0001 each	**1**	1

On 22 November 2017 the company issued a further 177,131,781 ordinary shares of £1 for consideration of £177,131,781.

On the 25 January 2018, the company completed a capital reduction. Prior to the capital reduction, share capital consisted of 5,105,581,781 ordinary shares of £1 that were allotted, called up and fully paid up. The capital reduction resulted in the share capital account being reduced by £5,105,071,223 to £510,558 by reducing the nominal value of the shares from £1 to £0.0001.

14 Contingent liabilities

Guarantees and letters of credit

Group undertakings have entered into bonds and guarantees in the normal course of business. No liability is expected to arise in respect of either bonds or guarantees.

15 Related party transactions

The company is exempt under FRS 101.8(k) from disclosing transactions with Quadgas HoldCo Limited and its subsidiary undertakings where all of the voting rights are held within the Group. There were no related party transactions with other companies.

Details of key management compensation are provided in note 7 to the consolidated financial statements.

16 Ultimate parent company

The ultimate parent and controlling company is Quadgas Holdings TopCo Limited and the immediate parent company is Quadgas PledgeCo Limited. The largest and smallest Group which includes the company and for which consolidated financial statements are prepared are headed by Quadgas Holdings TopCo Limited and Quadgas HoldCo Limited respectively. Quadgas Holdings TopCo Limited is registered in Jersey and Quadgas HoldCo Limited is registered in England and Wales.

Copies of Quadgas HoldCo Limited's consolidated financial statements can be obtained from the Company Secretary, Quadgas HoldCo Limited, Ashbrook Court, Prologis Park, Central Boulevard, Coventry, CV7 8PE.

Copies of Quadgas Holdings TopCo Limited's consolidated financial statements can be obtained from the Registered office, Quadgas Holdings TopCo Limited, 3rd Floor 37 Esplanade, St. Helier, Jersey JE1 1AD.