

REGISTERED NUMBER: SC264065 (Scotland)

Scotland Gas Networks Plc

Strategic Report, Directors' Report and

Audited Financial Statements for the Year Ended 31 March 2022

Scotland Gas Networks Plc (Registered number: SC264065)

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for the Year Ended 31 March 2022

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Scotland Gas Networks Plc

Company Information
for the Year Ended 31 March 2022

DIRECTORS:

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Paul Jeffery
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Michael Smart

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REGISTERED NUMBER:

SC264065 (Scotland)

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Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2022

The Directors present their strategic report for the year ended 31 March 2022. This strategic report sets out the main trends and factors underlying the development and performance of Scotland Gas Networks Plc ("the Company") during the year ended 31 March 2022 as well as those matters which are likely to affect our future development and performance.

THE BUSINESS, ITS OBJECTIVES AND STRATEGY

The Company operates the regulated gas transportation and metering business for the Scotland gas distribution network, one of eight regional gas distribution networks in Great Britain. Our gas distribution network comprises approximately 24,000 kilometres of gas mains delivering natural gas to approximately 1.8 million domestic, commercial and industrial customers. The network distributes gas in all of Scotland to 75% of households, including remote areas through the Scottish independent undertakings at Stornoway, Wick, Thurso, Oban and Campbeltown.

The Company is a wholly owned subsidiary of SGN MidCo Limited. The ultimate parent undertaking is Scotia Gas Networks Limited ("**SGN**"), which is registered at St. Lawrence House, Station Approach, Horley, Surrey, RH6 9HJ. During the year, Scotia Gas Networks Limited underwent an ownership change. It is now owned by a consortium consisting of Apple Newco Limited (37.5%) which is indirectly wholly owned by Ontario Teachers' Pension Plan Board, UK Gas Distribution 2 Limited (37.5%) which is indirectly wholly owned by Brookfield Super-Core Infrastructure Partners and Speyside Bidco Limited (25.0%), which is wholly owned by Global Infrastructure Partners (GIP). Previously, Scotia Gas Networks Limited was owned by a consortium consisting of SSE plc (33.3%), OTPPB Investments (UK) Limited (25.0%), which is owned by 2465817 Ontario Limited, Borealis Infrastructure Europe (UK) Limited (25.0%), which is indirectly wholly owned by OMERS Administration Corporation, and Blue Spyder B 2016 Limited (16.7%), which is owned by Abu Dhabi Investment Authority.

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

Objectives and Strategy

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

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

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

Our purpose is to keep everyone safe and warm. As outlined in our RIIO-GD2 business plan, our strategy is to deliver long-term value for existing and future customers, stakeholders and shareholders. This strategy is based on strong financial management and a governance framework, and underpinned by our detailed business plan and five strategic pillars:

1. Delivering safe and efficient service

We will deliver a safe and efficient service by acting safely, keeping the gas flowing and keeping costs down.

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2. Making a positive impact

We will make a positive impact on society, by supporting vulnerable communities and providing excellent service.

3. Building a shared future

We will build a shared net-zero future by accelerating decarbonised energy solutions and minimising our environmental impact.

4. Creating value and growing our service

We will create value by accelerating commercial opportunities which complement the core; maximise the value from our existing asset base; invest in opportunities for the sustainability of our network and keep SGN at the forefront of the delivery of heat.

5. Focusing on talent, skills and opportunities for our people

We will create and maintain an inclusive and diverse workplace where our people can develop and thrive.

External and regulatory environment

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

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

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

Factors affecting the business

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

- **Regulatory price controls**

The prices that can be charged for the use of the Company's networks are determined in accordance with regulator approved price controls. The year ended 31 March 2022 was the first year of the RIIO-GD2 price control. The key elements of revenue, outputs and allowed returns for the next five years have been set by the Regulator.

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Additionally, the regulatory price controls include an allowed rate of return for the investment the Company makes in the network. The allowed rate of return represents the return on debt and equity capital.

- **Safety and reliability of the networks**

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

- **Efficiency**

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

- **Interest rates**

The costs of financing our operations are affected by changes in interest rates as some of the Company's borrowings are held at floating rates. Exposure to changes in interest rates are hedged by holding both fixed rate and inflation-linked borrowings and by holding derivative financial instruments (interest rate swaps and inflation-linked swaps) where necessary to achieve the desired profile of interest rate risk. The cost of new debt raised by the Company is also affected by changes in interest rates. The Company aims to partially mitigate this risk by maintaining a smooth debt maturity profile to minimise annual refinancing requirements and spread future refinancing risk.

- **Inflation rates**

The value of the Company's regulated assets and its turnover are linked to inflation. Until 31 March 2021, the underlying rate of inflation applicable to the Company's assets and turnover was measured by the Retail Price Index ("RPI"). From 1 April 2021, inflation applicable to the Company's assets and turnover is now measured by the Consumer Prices Index including owner occupiers' housing costs ("CPIH"). A large part of the Company's cost base is also linked to various measures of inflation. The costs of financing our operations are also affected by changes in inflation rates as some of the Company's debt has principal and interest payments linked to either RPI or CPI. In addition, the Company is party to a variety of inflation-linked swaps, which have two payment legs linked to CPI. As such, the Company's financial performance, including its performance against various covenants, can fluctuate with inflation.

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2022**PRINCIPAL RISKS AND UNCERTAINTIES**

Our risk profile aligns with our obligations of a gas utility to provide an essential service and considers the statutory and regulatory environment as well as stakeholder expectations. Our emphasis is to anticipate threats and build a foundation for long-term resiliency.

At the start of RIIO-GD2 we reviewed our principal risks to ensure that our approach would support the achievement of the strategic objectives that underpin our RIIO-GD2 plan and Final Determination.

During the year we have re-assessed our principal risks to consider developing scenarios, their associated consequences, and planned mitigations, drawing from:

- Priority risks recorded in each of the operating-facing units as well as the corporate units.
- Ongoing input from our senior leaders.
- Key external factors impacting upon the gas utilities sector.

Our principal risk profile consists of 12 risks reflecting the changing nature of the business environment, political and regulatory environment, RIIO-GD2 strategic objectives and other external risks. Our risk profile is relatively stable with no new risks included or removed since last update.

The principal risks and uncertainties identified are as follows:

Description and Impact of Risk	Mitigation
1. Future of gas network: The shift towards a decarbonised energy system presents several risks to our business model, funding, regulatory framework and organisational capability as decisions from government on climate change expected to lead to an outcome being one that does not rely on natural gas.	<p>Influencing government policy and regulatory decisions by setting up of a collaborative body of networks, industry, BEIS, and Ofgem.</p> <p>Co-ordination of the hydrogen programme evidence and activity through the BEIS Programme Management Board and the Gas Goes Green Pathway supported by the Energy Networks Association.</p> <p>Delivering the SGN evidentiary framework and developing plans for heat decarbonisation rollout including hydrogen and biomethane.</p> <p>Utilising innovation funding and working with others to test and deliver evidence for potential decarbonisation pathways.</p> <p>Developing a heat network diversification option.</p>

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Description and Impact of Risk	Mitigation
<p>2. Cyber and IT resilience: Failure to implement appropriate security risk management and crisis management could result in cyber-attacks from nation states, hactivists, criminals, and/or insiders.</p> <p>Loss of critical IT services due to the design of core services and/or ineffective Business Continuity Management plans. Loss of IT services could result in interruption or disruption to our core business operations.</p>	<p>Secured uplift in Cyber security funding to combat risk.</p> <p>Developed a managed security service with an external partner to complement a skilled in-house security team to improve the defensive capability of our organisation.</p> <p>Working closely with our industry peers and government agencies to shape our delivery of the security programme as well as complying with the directives.</p> <p>Ongoing work to maintain business continuity and disaster recovery procedures focusing on consequences of geo-political actors or malicious activity.</p> <p>Hardware and Network resilience/segmentation in place.</p> <p>Maintenance plan and activities in place to manage the risk of failure.</p> <p>Raising staff security awareness through training and awareness campaigns.</p>
<p>3. Political and public policy: There is a risk that adverse future intervention by the UK and Scottish Governments in the energy markets, or changes in governmental policy, may have an unfavourable impact on our business model.</p>	<p>Contributing to development of UK and Scottish Government policy.</p> <p>Continue to build capability within the Company to promote our brand and explain our role.</p> <p>Communications campaign to build political and public awareness of SGN net zero solutions.</p> <p>Targeted engagement with Local Authorities to develop decarbonisation plans.</p> <p>Accelerated pathway developed for hydrogen transition.</p> <p>Assessment of Scottish independence risk/opportunity to SGN.</p>

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Description and Impact of Risk	Mitigation
<p>4. Leadership, people and culture: Failure to maintain a sufficiently competent, diverse and productive workforce with effective relationships and enough talent. Also, the failure of the leadership team to recognise the changing external and internal environment and indifference to business risks.</p>	<p>Continuous development of our people with right skills and knowledge to deliver business objectives.</p> <p>Training and development for all employees including talent management programmes.</p> <p>Developing change management and training to support faster and more cost-effective operations.</p> <p>Responding to regulatory, supplier and technology developments which may impact on company strategy.</p> <p>Recruitment review to attract people from a wide and diverse pool.</p> <p>Three-year pay deal protecting employees against inflationary pressures, as well attracting and retaining new people.</p>
<p>5. Safety and Health: Failures in the design or implementation of the safety and health management systems may result in unsafe behaviour and working practices.</p>	<p>We have a continued focus on safety across all assets and operations.</p> <p>We track a range of safety metrics very closely and have programmes in place to drive improvements.</p> <p>We review lessons learnt from major incidents in order to prevent such things from recurring.</p> <p>Compliance is supported by independent inspections and an audit programme.</p> <p>We run wellbeing programmes and campaigns for our people.</p> <p>Continued focus on SGN's safety culture.</p>
<p>6. Financing: The risk that the Company is unable to, or that it costs the Company materially more to raise equity or external debt financing to refinance existing debt or to fund further investment.</p>	<p>The Company has a treasury policy that is focused on maintaining:</p> <ul style="list-style-type: none"> - 12-18 months committed sources of liquidity (cash and committed facilities) within the Company; - A smooth debt maturity profile to minimise annual refinancing requirements and spread refinancing risk; - Access to diversified sources of funding to avoid over-reliance on any one market;

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Description and Impact of Risk	Mitigation
<p>- A proportion of direct or synthetic inflation debt liabilities to hedge the Company's assets and cash flows.</p> <p>Regular internal monitoring and reporting of key credit metrics and financial covenants to the Executive Committee, Finance Committee and Board.</p> <p>The Company has a dividend distribution policy that is flexible and linked to maintaining credit metrics in line with solid investment grade credit ratings.</p> <hr/> <p>7. Environment and climate adoptions: As we move to a zero-carbon economy there is a risk of failing to assess and manage changes as a result of climate change impacts, zero-carbon legislation and policy, market and investor requirements and technological change.</p>	<p>- A proportion of direct or synthetic inflation debt liabilities to hedge the Company's assets and cash flows.</p> <p>Regular internal monitoring and reporting of key credit metrics and financial covenants to the Executive Committee, Finance Committee and Board.</p> <p>The Company has a dividend distribution policy that is flexible and linked to maintaining credit metrics in line with solid investment grade credit ratings.</p> <hr/> <p>Delivering the Environmental Action Plan and Environmental Sustainability Strategy by decarbonising the network and operations.</p> <p>Engaging with the supply chain to support their journey of decarbonisation and environmental improvement.</p> <p>Delivering regular interaction with stakeholders and customers, including continuous collaboration with the SGN Environment Advisory Panel.</p> <p>Engaging with peers and other companies in the energy and infrastructure sectors to enable a best practice approach, e.g. through the ENA, and industry groups Scottish Infrastructure Circular Economy Forum (SICEF) and Major Infrastructure Resources Optimisation Group (MI-ROG) on circular economy.</p> <p>Full implementation of behavioural and cultural improvement aligned with our safety culture approach.</p> <p>Maintaining our ISO14001 accreditation.</p> <p>Understanding and assessing climate risk to occupied sites.</p> <hr/> <p>8. Legal and compliance: Legal risk is the risk of financial or reputational loss that can result from lack of awareness or misunderstanding of, or ambiguity in, the way law and regulation apply to your business, its relationships, processes, products and services.</p>
	<p>We are progressing programmes to strengthen our compliance framework, supported by relevant training for those in high-risk roles.</p> <p>We have policies covering controls including confidentiality, conflicts of interests, gifts and hospitality, money laundering, anti-bribery and data protection.</p>

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Description and Impact of Risk	Mitigation
	<p>Our contracts include anti-bribery, anti-facilitation of tax evasion, confidentiality, modern slavery and data protection clauses.</p> <p>Ongoing assessments to help the business manage compliance risks associated with business change/developments.</p>
	Annual Compliance Report.
<p>9. Supply chain: The risk of disruption to supply continuity if there is over-dependence on a limited number of suppliers and/or failure to meet increased expectations for sustainable procurement due to lack of co-ordination with supplier partners.</p>	<p>Developing and harnessing new suppliers to encourage competition and innovation.</p> <p>Supplier performance management and compliance across key areas.</p> <p>Ongoing support and management of contracts to maximise commercials for both parties.</p> <p>Preparation to deal with short term and long-term shocks.</p> <p>Online sourcing system.</p> <p>Ukraine Working Group set up to monitor potential supply chain impacts and mitigating measures.</p>
<p>10. Network asset management and physical security: Failures in the design and/or implementation of our asset management policy, management and security systems and procedures, or ineffective crisis management causing reputational damage and shareholder dissatisfaction.</p>	<p>Clear asset investment strategy out to March 2026.</p> <p>Core business processes help ensure that gas supply to the customer is maintained.</p> <p>Long-term horizon scanning is in place to capture network asset changes.</p> <p>There is robust annual audit programme and site inspections to ensure compliance with our policies and procedures.</p> <p>We track a range of asset and safety related metrics very closely and have programmes in place to drive improvements.</p> <p>We test resiliency through a number of activities such as emergency exercises and risk assessment tools.</p>

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Description and Impact of Risk	Mitigation
	Physical security upgrade programme is designed to meet government agencies guidelines.
	Take lessons from incidents within SGN and externally.
11. Customer interests: Failure to maintain high levels of customer service, in particular with our most vulnerable customers, could lead to financial penalties, reputational damage, business stagnation and loss of trust with a range of stakeholders from local communities to national government.	<p>The new CXGD2 (Customer Experience GD2) project.</p> <p>Vulnerable Customer Strategy to harness new suppliers and to encourage competition and innovation in the area of vulnerability.</p> <p>Ongoing support and management of external relationships to maximise collaboration and co-operation of all partners.</p>
12. Licence conditions: Failure to comply with our licence conditions and obligations.	<p>We have governance and compliance frameworks in place to deal with issues and developments arising from price controls.</p> <p>Our experienced regulation, finance and legal teams manage compliance requirements and engage with all levels of Ofgem and Government.</p> <p>Delivery of regulatory outputs is measured and monitored on a regular basis.</p>

The oversight of the enterprise risk management system is Board-led with ongoing input from the Executive giving visibility to the nature of risks and extent of risks facing the organisation.

Oversight of the principal risks remains effective through several established routes during the year.

- Each principal risk is assigned an Executive risk owner who is responsible for monitoring the exposure and nature of the risk deciding how it should be managed and taking the necessary action to bring it back to the desired target level.
- Detailed reviews involve the Executive risk owner providing an overview of the risk, recent developments, and how we are currently managing it as well as improvement areas.
- Collective reviews at the Risk Committee and the Executive on a quarterly basis and every six months at the Board.

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Enhancing our risk framework

Continuous improvement is a key component of our enterprise risk management framework. In recent years we have matured fundamental aspects of our enterprise-wide risk management approach.

- We have partnered with a specialist provider to assess our risk governance and support our ongoing maturity of the risk framework.
- We have benchmarked our risk profile with other utilities to gain insight and understanding of different approaches.
- We have increased engagement with our Risk Committee to provide risk owners with increased comfort, knowledge, and capability to manage their risks.
- We have extended the remit of our Risk Committee to cover risk and resilience, in recognition of the strategic importance of resilience across the organisation.

On a regular basis, the Executive members have assessed the principal risks facing the Company collectively, recognising that different risks can materialise at the same time and/or potential interactions among risks, including risk concentrations and contingent risks. In making this assessment, the Executive and the Board are in a position to understand potential worst-case scenarios and our response and mitigations.

Stakeholders

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

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for the Year Ended 31 March 2022**SECTION 172(1) STATEMENT**

The Companies (Miscellaneous Reporting) Regulations 2018 require Directors to explain how they considered the interests of key stakeholders and the broader matters set out in section 172(1) (A) to (F) of the Companies Act 2006 ('S172') when performing their duty to promote the success of the Company under S172. In particular, how they have considered the long-term success of the company whilst balancing the interests of a wide range of stakeholders.

Confirmation of Directors' duties

The Company's Directors strive to ensure that they act in good faith, in promoting the future success of the Company, and in doing so having regard (among other matters) to:

S172(1) (A) "The likely consequences of any decision in the long-term"

The Directors' role is to promote the long-term success of the Company through the setting of a clear purpose, vision and sustainable strategy which creates value for existing and future customers, stakeholders and shareholders.

The Board have provided continued focus on the long-term success of the Company through the approval of a refreshed purpose, vision and values, following extensive internal and external research programmes. These are outlined further in the points below and throughout the Strategic and Directors' Report.

S172(1) (B) "The interests of the company's employees"

The Directors place considerable value on the involvement of its employees. It has continued to keep them informed on matters affecting them and on the various factors affecting the Company.

Several of the Board's sub-committees have a high degree of focus on employee's interest, for example the Safety, Health and Environmental Advisory Committee which recognises that the health and safety of the Company's staff (as well as the other key stakeholders) are of critical importance. The People and Reward Committee also considers the appropriateness and relevance of the remuneration policy.

The Directors recognise that our pensioners, though no longer employees, also remain important stakeholders.

S172(1) (C) "The need to foster the company's business relationships with suppliers, customers and others"

The Directors' have taken steps to ensure everyone has an opportunity to share their views about what matters to them with the Company.

We have well-established customer engagement channels ranging from dedicated panels and focus groups to ensure perspectives of vulnerable customers are considered, to forums to engage with large business customers. Customer satisfaction surveys drive KPIs which measure how successful we are and provide feedback on the impact of our decisions. We use consumer research groups to engage and shape the key decisions we make. We use social media and our website to communicate directly with our customers. The Consumer Engagement Group (CEG) and Stakeholder Advisory Panel (SAP) help shape our engagement strategy by providing independent challenge on the use of our customer engagement in our business planning.

The Company has used the valuable insight gathered from our customers and stakeholders to shape our business, and now structure our activities to align with the customer and stakeholder-driven commitments:

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- We will make a positive impact on society, by supporting vulnerable communities and providing excellent service.
- We will deliver a safe and efficient service by acting safely, keeping the gas flowing and keeping costs down.
- We will build a shared net-zero future by accelerating decarbonised energy solutions and minimising our environmental impact.
- We will create value by accelerating commercial opportunities which complement the core; maximise the value from our existing asset base; invest in opportunities for the sustainability of our network and keep the Company at the forefront of the delivery of heat.

We work closely with suppliers as well to ensure their values on issues, such as, safety, environment and modern slavery are upheld throughout our supply chain. Meetings are held with strategic suppliers through our Supplier Relationship Management (SRM) programme, helping enhance performance and strengthen relationships to deliver mutual value as well as key relationship meetings with our Executive and CEO.

During the period, the Directors received information to help them understand the interests and views of the Company's key stakeholders and other relevant factors when making decisions. This information was distributed in a range of different formats including in reports and presentations on our financial and operational performance, non-financial KPIs, risk and the outcomes of specific pieces of engagement (for example, the results of customer and supplier surveys and focus groups).

As a result of this, the Directors have had an overview of engagement with stakeholders and other relevant factors which allows them to understand the nature of the stakeholders' concerns and to comply with their Section 172 duty to promote the success of the Company.

S172(1) (D) "The impact of the company's operations on the community and the environment"

Working with communities at local, regional and national levels enables us to build our shared net-zero future by accelerating decarbonised energy solutions and minimising our environmental impact.

During the year, the Board has approved continuing investment in our Cyber Security Programme. By not investing in cyber resilience, we would put our company at risk of attacks from national states, hacktivists, criminals and/or insiders.

The UK National Cyber Security Strategy 2016-21 identified that cyber-attacks are growing more frequent, sophisticated and damaging. We, along with UK Government and Ofgem, recognise the scale of the cyber threat to critical national infrastructure, such as our gas networks.

In our 2021-26 RIIO-GD2 business plan, we committed to keeping our network safe and resilient to keep our customers safe from cyber and physical attacks. To ensure our continued cyber resilience, we must substantially increase our cyber security and that requires significant financial investment.

S172(1) (E) "The desirability of the company maintaining a reputation for high standards of business conduct"

The Directors' aim to ensure that the Company maintains high standards of business conduct through the support of the Company's culture and values which underpin decision making at a Board and management level.

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Our previous vision and values were determined in 2005 when the company was first formed. Our vision was to be dedicated to keeping our customers safe and warm by leading the way in energy delivery. This was supported by our five values:

- **Safety first** - We take responsibility for our own safety and the safety of those around us
- **Driving performance** - Efficiency, innovation and continuous improvement will help us deliver excellence and achieve commercial success
- **Putting people at the heart** - we always work together, talk honestly and trust people with respect
- **Looking after customers** - by listening to our customers, understanding their needs and keeping our promises we can deliver an excellent service that people trust
- **Sustaining our world** - we maximise our effect on local communities and minimise our impact on the world

As we look ahead to a net-zero energy future, we recently amended our existing vision and values to reflect our organisation as we are now, and our aspirations throughout RIIO-GD2 to unite and engage our employees through the energy transition.

During the year, having undertaken an extensive programme of engagement with around 1,300 of our people working across our business, including our Board, as well as consulting external stakeholders, we have established the following purpose, vision and values:

Our purpose

Serving our communities by keeping everyone safe and warm.

Our vision

To give our customers the best clean energy experience.

Our values

Safety, innovation, reliability, openness, respect

S172(1) (F) "The need to act fairly as between members of the company"

The Directors recognise the responsibility to act fairly as between members of the company. This is outlined by the Company's vision, purpose, and engagement which is supported by the Board of Directors.

These are outlined further in the points above.

The Directors' Report outlines examples of how each of the sub-committees of the Board have applied these principles in key decision-making activities.

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ENGAGEMENT WITH EMPLOYEES

We will only deliver our vision if we recruit, skill and retain the best talent and develop a flexible, motivated, efficient, diverse and engaged team.

We have numerous, established channels for engaging with our people, whether they're field-based, home-based or work from our offices and depots. This year, we've also introduced a new audio channel, EnergyFM, and our digital magazine Future Proof.

Our internal communication channel SGNapp continues to successfully enable us to reach every employee - regardless of where they're based - and share multiple news stories and organisational updates each day, while also facilitating open and honest two-way communication between colleagues across all levels of the business.

This two-way approach to engaging our people is reinforced through on-site and office visits, Let's Chat sessions, employee forums and structured engagement with trades unions and pension trustees. Our senior leaders are supported to engage their teams through monthly Extended Leadership Team town hall sessions, Team Talk, safety briefings and regular 121s.

Our diversity and inclusion networks help us promote a diverse and inclusive culture through events and awareness campaigns, including D&I Partners, Let's Talk about Race and Rise Programme. Expanding our People Portal HR platform to include an online learning portal allows our people to become more engaged in their development and career progression.

We use employee surveys to help measure the progress of our engagement plans and make sure we're moving in the right direction. More than 60% of our colleagues participated in our annual employee engagement survey.

Engagement with our people ensures that employees remain informed about business strategy and developments in real-time. Corresponding feedback allows both management and the Board to ensure areas of importance highlighted by employees' perspectives are considered and reflected in future decisions and communications. The employee engagement survey results are reviewed at management, Executive and Board level. Each business area uses the feedback to develop action plans and inform its approach, which is communicated to employees and teams.

Key board decisions made in the year that impact our employees:

- Approval of refreshed purpose, vision and values
- Agreement of the fleet purchase framework for procuring new operational vehicles for our teams

ENGAGEMENT WITH SUPPLIERS, CUSTOMERS AND OTHERS

Engaging with our stakeholders is fundamental not just to our day-to-day activity, but fundamental to the long-term success of our business. It's this invaluable, continual insight generously shared by our wide range of stakeholders that helps the Board shape policies and practices, best predict future developments, and react to emerging threats and trends.

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We are a business which truly listens to our stakeholders, taking steps to ensure everyone has an opportunity to share with us their views about what matters to them. We've used the valuable insight gathered from our customers and stakeholders to shape our business, and now structure our activities to align with the customer and stakeholder-driven commitments:

- We will make a **positive impact** on society, by supporting vulnerable communities and providing excellent service.
- We will deliver a **safe and efficient** service by acting safely, keeping the gas flowing and keeping costs down.
- We will build a **shared future** by accelerating decarbonised energy solutions and minimising our environmental impact.
- We will **create value** by accelerating commercial opportunities which complement the core; maximise the value from our existing asset base; invest in opportunities for the sustainability of our network and keep the Company at the forefront of the delivery of heat.

Continuous Improvement

We strive for continuous improvement in our approach to stakeholder engagement. Our longstanding six principles guide our approach to stakeholder engagement and are detailed below.

1. Delivering measurable benefits:

We will engage directly with customers and stakeholders to embed their interests in our decision-making and deliver valued, measurable benefits.

2. Focusing on material issues:

Customers and stakeholders should have a say in relevant issues they care about and that will have the most impact on them, both now and in the future.

3. Driving inclusivity and diversity:

Engagement with customers and stakeholders should be broad and inclusive; we will seek out the diverse perspectives of challenging and hard to reach groups and ensure complex issues are communicated in a way that is easily accessible and understandable to all.

4. Providing ongoing opportunities for challenge and collaboration:

Engagement will be tailored to the needs of stakeholders to ensure genuine opportunities for ongoing dialogue, mutual education, challenge, review and collaboration are created.

5. Being responsive and transparent:

The Company will be responsive and transparent, explaining how the views and priorities of stakeholders have influenced decision-making and how we have balanced the needs of different stakeholders.

6. Continually improving:

The Company will continuously improve and develop its engagement with customers and stakeholders, finding new and more innovative approaches to respond to their changing needs.

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2022**Our six-stage engagement cycle**

Our engagement strategy details the six, iterative stages of our engagement cycle we use to embed the above principles of stakeholder engagement across our organisation. These are as follows:

1. For each of our key businesses priorities and processes we identify the stakeholders impacted by or interested in our activities
2. We tailor our methods of engagement with our stakeholders depending on their preferences and their levels of knowledge and interest
3. We engage with a purpose and listen to our stakeholders
4. We respond to the views of stakeholders across our business
5. We measure the benefits of our engagement and its effectiveness
6. We review and refine our strategy and engagement plans

Identifying and mapping our key stakeholders

Our digital Stakeholder Relationship Management (SRM) tool allows us to capture and analyse our engagement activities with a diverse range of stakeholders across our business. We use SRM to maintain records of which topics each stakeholder has told us are priorities or of interest to them, the geographical areas in which they operate and their communication preferences. Our stakeholders are categorised into one of ten main groups as outlined below.

Supporting Section 172

A critical aspect of working constructively with the Company's key stakeholder groups is the engagement which takes place to understand material issues of interest and set out below are details of the engagement mechanisms that exist within the Group, which ultimately support the Board's understanding of relevant stakeholder views. This approach ensures that all decision-making is adequately informed and is supportive of a Director's duty under Section 172 of the Companies Act 2006.

Stakeholder type	Key stakeholders	2021/22 Board impact areas
Internal Stakeholders SGN employs around 3,800 people across its workforce and has three shareholders.	Employees/workforce, trade unions, shareholders	<p>Approval of refreshed purpose, vision and values</p> <p>Agreement of the fleet purchase framework for procuring new operational vehicles for our teams</p> <p>Appointments of the new board March 2022 and dividends</p>
Debt investors SGN has a large debt provider base	Bank lenders, public debt investors, private placement investors and rating agencies	<p>Cancellation and settlement of mirror swaps</p> <p>Tansacted £130m of CPI-linked swaps</p> <p>Transition of all GBP LIBOR based financing and risk management arrangements to SONIA</p>

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2022

Customers SGN keeps gas flowing safely and reliably to 5.9 million homes and businesses, all day, every day	Domestic and industrial customers, small and medium enterprises, future gas customers	GD2 Customer Strategy approved
Regulatory bodies SGN works constructively and collaboratively with regulatory bodies such as Ofgem and the HSE.	Ofgem, HSE, Environment Agency, SEPA	Review of Supplier of Last Resort (SoLR) and impacted parties Approval of continuing investment in our Cyber Security Programme Decarbonisation projects
Local government SGN works constructively and collaboratively with both UK and Scottish Governments as well as local authorities	Government departments, local authorities, politicians, local energy plan partners	Review of Supplier of Last Resort (SoLR) and impacted parties Approval of continuing investment in our Cyber Security Programme Decarbonisation projects
Energy partners and industry peers SGN works in collaboration with third party energy partner providers and industry peers	GDNs/DNOs, shippers/suppliers, industry groups, IGTs/UIPs, other utilities (water, telecom, etc.)	Decarbonisation projects
Supply Chain SGN works closely with its supply chain	Appliance manufacturers, construction and engineering companies, services providers	New framework instituted for GD2 contracting
Local interests SGN works in partnership with many third-party organisations to support local interest	Community groups, energy and health services, public transport providers, housing providers	Decarbonisation projects
Environmental experts and Advisory groups SGN works closely with its environmental groups to ensure it minimises its environmental impact	NGOs, environmental charities, sustainability specialists	Decarbonisation projects
Consumer welfare agency groups/providers SGN works closely with its consumer welfare groups to support vulnerable communities	Consumer groups, charities, private and community interest groups	Decarbonisation projects

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2022**Key performance indicators**

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

Key performance indicator	Description	Year ended 31 March 2022	Year ended 31 March 2021
Revenue	Income relating to the transportation of natural gas and provision of related services	£339m	£384m
Operating profit	Profit before financing costs and taxation	£ 108m	£164m
Capital expenditure [1]	Additions to fixed assets	£46m	£47m
Replacement expenditure [1]	Replacement expenditure is capitalised under FRS 102. It represents the cost of renewing sections of gas network with polyethylene pipes.	£54m	£53m
Net debt to RAV ratio [2]	The Company's net debt to RAV ratio	69.5%	71.0%
Employee lost time incidents	Incidents resulting in employees taking time off work (per 100,000 hours worked)	0.06[3]	0.06 [3]
Customer satisfaction - planned interruptions	Results from customer satisfaction surveys(10 = very satisfied)	9.20 [4]	9.0 [4]
Customer satisfaction - unplanned interruptions	Results from customer satisfaction surveys (10 = very satisfied)	9.54 [5]	9.6 [5]
Escapes attendance	Proportion of uncontrolled escapes attended in one hour - percentage (target 97%)	98.1%	99.0%
Customer complaint volume reduction/increase	This represents the year-on-year reduction in complaints expressed as a percentage. Complaint means any expression of dissatisfaction related to any areas of our operation.	15% increase [3]	39% decrease [3]

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2022

- [1] The sum of capital expenditure and replacement expenditure equal the total additions of intangible and tangible fixed assets as reported in notes 11 and 12 respectively.
- [2] "RAV" is defined as Ofgem Regulatory Asset Value plus adjustments relating to the sharing of out/under performance against allowances. Net debt for the purposes of the Net Debt to RAV ratio includes unrestricted cash, short term deposits, intercompany loans, accretion to date on inflation-linked instruments, but excludes forecast liabilities arising from derivative financial instruments. The percentages stated are as at 31 March.
- [3] This KPI is measured for the Group, and accordingly the data presented is that for the Group.
- [4] Based on customer satisfaction survey reports.
- [5] Based on customer satisfaction survey reports.

Alternative performance measures

Group APM	Closest equivalent UK GAAP measure	Adjustments to reconcile to primary statements	Rationale for adjustments
Net debt to Regulated Asset Value (RAV) ratio	Borrowings less cash and cash equivalents	Net debt (before issue costs), excluding shareholders' loans and future liabilities arising from derivative financial instruments and net of cash and cash equivalents. RAV is as reported to Ofgem in the Regulatory reporting pack. This does not have a statutory equivalent.	Governed by specific licence conditions and covenants imposed on us due to the nature of the business.
Capital expenditure	Tangible and intangible fixed asset additions	Tangible and intangible fixed asset additions excluding replacement expenditure	This is an Ofgem driven performance measure.
Replacement expenditure	Tangible and intangible fixed asset additions	Tangible and intangible fixed asset additions excluding capital expenditure	Due to the nature of the business, replacement expenditure is material to the financial statements and thus it should be disclosed separately.

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2022**Resources**

The Company's principal resources are its assets and its people. The Company's distribution network comprises approximately 24,000 kilometres of gas mains, together with associated services, plant and machinery and storage facilities.

The Company had 236 full time equivalent employees at 31 March 2022 (2021: 275). It places considerable value on the involvement of employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the Company during the year. It continues to invest in the development and training of its people to ensure both individual developmental needs and business skill requirements are met.

FINANCIAL REVIEW

The Company sets out below its financial review for the year ended 31 March 2022. The comparative figures presented are for the year ended 31 March 2021, as reported in the audited financial statements, unless otherwise stated.

Turnover for the year ended 31 March 2022 was £339m (2021: £384m). The decrease in revenue was attributable to a reduction in allowances following GD2, resulting in a reduction in revenues for 2021/22.

Profit for the year before taxation amounted to £28m (2021: £119m) and loss for the year after taxation amounted to £(51)m (2021: £96m profit). The current year tax charge is significantly higher than the tax charge in the year ended 31 March 2021. This is mainly due to a change in the main rate of corporation tax from 19% to 25% which has been substantively enacted at the balance sheet date and as such deferred tax has been calculated at the higher rate accordingly, resulting in an increase in the Company's deferred tax liability.

Operating profit decreased to £108m (2021: £164m) driven by the above-mentioned decrease in turnover. The Company has felt the impact of the rises in wholesale gas prices, with the cost of shrinkage (gas lost from the network) for 2022 totalling £9m, up from £2m in 2021.

The Company transacted £130m of CPI linked swaps during the year, that economically switch all or part of the notional principal of certain fixed rate debt instruments into CPI-linked debt instruments. Included within Fair value movement on derivatives in the Profit and loss account at the yearend is £7m of accretion on CPI-linked swaps (31 March 2021: £nil) and £6m of mark-to-market movement (2021: £nil).

The Company paid dividends of £51m (2021: £75m) during the year.

Capital expenditure (excluding replacement expenditure) during the year amounted to £46m (2021: £47m). Capital expenditure is incurred to ensure that the networks continue to operate at minimum agreed pressures and that sufficient storage capacity is available to meet instances of peak demand, as well as when new connections or increased capacity are added to the networks. Capital expenditure has remained consistent with previous year spending.

Treasury policies and capital structure

The Company's operations are financed by a combination of equity and retained profits, bank loans, private placements and public bonds. The Company's funding and liquidity are managed within a framework of policies and guidelines authorised by the Board of Directors. Further details are set out in the Directors' Report.

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2022

As a matter of policy, a minimum of 75% of debt is maintained at either fixed rate of interest or inflation linked. This policy is kept under review from time to time. Derivative financial instruments, including interest rate swaps and inflation-linked swaps are used, where necessary, in order to achieve this desired profile.

As at 31 March 2022, the Company's total senior debt (before issue costs) amounted to £1,389m (2021: £1,357m) and the net debt to RAV ratio was 69.5% (2021: 71.0%). Of the total debt at 31 March 2022, after taking into account the effect of interest rate swaps and inflation-linked swaps, 95.3% were at either fixed rates of interest or were inflation-linked (2021: 95.2%).

Pension commitments

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

The Company accounts for any pension asset or liability in accordance with FRS 102. The net pension asset as at 31 March 2022 was £145m (2021: £119m). Annual special pension contributions for the Group remain £12.5m (2021: £12.5m) (Company's share: £5m). These additional contributions were paid annually until 31 March 2022 to repair the actuarial deficit in the defined benefit pension scheme. The Company's normal contributions remain at 37.3%. The Company's actuary undertook a triennial review during 2018/19 to update the actuarial deficit for recent changes in external and market conditions.

Liquidity risk

Liquidity is maintained through a mixture of long-term borrowings and short-term liquid funds in order that there are sufficient funds available for the Company's current and planned operations. Committed facilities are in place in order to provide funding for future capital and replacement expenditure as well as to provide sufficient available facilities to meet the seasonal working capital requirements of the Company. The revolving credit facilities totalled £360m for the Group (2021: £360m) and are in place until March 2025; as at 31 March 2022 £330m is undrawn (2021: £360m). At 31 March 2022 the Company's committed revolving credit facility, which was fully undrawn, amounted to £235m (2021: £120m).

Counterparty credit risk

The Company transacts with banks for the provision of deposits, interest rate, inflation and currency hedging transactions. Under the Group's hedging policy, counterparties must maintain minimum credit ratings with appropriate collateral posting and replacement thresholds based on each counterparty's long-term credit ratings. At the year end the Company had £70m payable relating to financial instruments with bank counterparties (2021: £79m).

Dividend policy

The Company's policy is to manage the level of distributions after taking into consideration the expected cash flows and investment plans across the business, the level of committed funding available as well as the financial covenants and credit metrics of the Company and targets set by the Board. The inherent risk in the business and the wider economy is also considered.

Accounting policies

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

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2022**OPERATIONAL REVIEW****Safety****Injury performance**

The Company's overriding goal is to distribute gas safely and reliably and to ensure a safe workplace for its workforce with everyone striving towards eliminating injuries. This year the lost time injury performance rate decreased to 0.06 injuries per 100,000 hours (2021: 0.06).

Board responsibility

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

Gas mains replacement programme

The Company replaces the iron pipes with modern polyethylene pipes to improve the safety of the existing network. Replacement expenditure, primarily of iron pipes, reduced to £54m (2021: £53m). In line with movement in capital expenditure, replacement expenditure has also remained at similar levels to the previous year.

Gas escapes standards of service

The Company's engineers respond to reports of suspected gas leaks 24 hours a day, 365 days a year, regardless of from whom people buy their gas. Its engineers aim to attend all uncontrolled gas escapes within one hour and all controlled gas escapes within two hours. A controlled gas escape is one where the person reporting it has confirmed that the gas emergency control valve serving the premises has been turned off and the smell of gas has gone. An uncontrolled gas escape covers all others. The Company's engineers exceeded Ofgem targets by attending over 98.1% (2021: 99%) of uncontrolled gas escapes within one hour.

Gas networks' regulation

The RIIO-GD2 price control period began on 1 April 2021. In February 2021, the Board took the decision to refer Ofgem's Final Determination for RIIO-GD2 to the Competition and Markets Authority (CMA). In the CMA's announcement in October 2021, they upheld the determination of allowed cost of equity, but was found to be wrong or partially wrong on other factors. They found that Ofgem was wrong to impose an outperformance wedge (the 25bps determination from the allowed return on equity), and as such it was removed. The CMA also found in favour for SGN that Ofgem wrongly applied the innovation uplift in addition to ongoing the efficiency challenge.

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

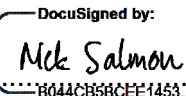
Scotland Gas Networks Plc (Registered number: SC264065)

Strategic Report
for the Year Ended 31 March 2022

Further details

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

APPROVED BY THE BOARD OF DIRECTORS AND SIGNED BY:

DocuSigned by:

.....
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Nicholas Robin Salmon (Chair) - Director

Date: 25-07-22 | 12:17 PM BST
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Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report
for the Year Ended 31 March 2022

The Directors present their report and the audited financial statements for the year ended 31 March 2022.

PRINCIPAL ACTIVITY

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

DIVIDENDS

The Company paid an interim dividend of £51m (2021: £75m). The Directors do not recommend the payment of any final dividend for the year (2021: £nil).

FUTURE DEVELOPMENTS

Details of future developments can be found in the strategic report.

EVENTS SINCE THE END OF THE YEAR

Information relating to events since the end of the year is given in the notes to the financial statements.

DIRECTORS

The Directors shown below have held office during the whole of the period from 1 April 2021 to the date of this report.

Charlotte Brunning
Paul Jeffery
Charles Thomazi (Alternate)
Laura Sandys
Nicholas Robin Salmon (Chair)

Other changes in Directors holding office are as follows:

Gregor Alexander - resigned 22 March 2022
Guy Lambert - resigned 22 March 2022
Robert McDonald - resigned 22 March 2022
Peter Mccosker (Alternate) - resigned 31 May 2021
Michael McNicholas - resigned 23 March 2022
Delphine Voeltzel - resigned 1 July 2021
Michael Botha - appointed 22 March 2022
Rebecca Lumlock - appointed 22 March 2022
Felipe Ortiz - appointed 22 March 2022
Paul Trimmer - appointed 23 March 2022
Adam Friedrichsen - appointed 1 July 2021 - resigned 23 March 2022
Henrik Onarheim - appointed 5 July 2021 - resigned 22 March 2022
Martin Catchpole – appointed 23 March 2022

DIRECTORS' INSURANCE AND INDEMNITIES

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

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report
for the Year Ended 31 March 2022

REVIEW OF BUSINESS

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

FINANCIAL RISK MANAGEMENT

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

Interest rate risk

The Company has interest bearing liabilities, and as a matter of policy a minimum of 75% of debt is maintained at either fixed rate of interest or inflation linked. This policy is kept under review and is updated as deemed necessary by the Board. The Company uses derivative financial instruments, including interest rate swaps and inflation-linked swaps, where necessary, in order to achieve this desired profile.

Inflation rate risk

The Company's regulated asset base and turnover are linked to inflation as measured by CPIH, which can decrease as well as increase. The Company partially manages this risk by maintaining a level of inflation-linked debt, whereby the interest and final principal payment on this debt is linked to inflation. As a matter of policy the Company aims to maintain 35% of its debt portfolio in inflation-linked. The Company also uses inflation-linked swaps, where necessary, to achieve this profile.

Foreign exchange risk

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

The Company has issued placement notes in the US that are denominated in Sterling where there is some underlying exposure in USD. On these transactions, the noteholders have transacted a derivative instrument to hedge the USD exposure into Sterling and as a result the Company does not carry a material exposure to USD under the transactions.

The Company is party to contracts for the provision of various goods and services where the payment currency for the contract is not in Pound Sterling. The Company may enter into short-term foreign exchange transactions, including derivative financial instruments, to hedge any foreign exchange risk arising from payments under these contracts.

Liquidity risk

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

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report
for the Year Ended 31 March 2022

Credit risk

The Company transacts with banks for the provision of deposit, interest rate, inflation and currency hedging transactions. Under the Group's hedging policy, counterparties must maintain minimum credit ratings with appropriate collateral posting and replacement thresholds based on each counterparty's long-term credit ratings. In respect of short-term cash management, counterparties are subject to review and approval according to defined criteria, with limits set on both the aggregate amount of investment and the investment term based on the credit rating of the counterparty. All investment counterparties must carry a minimum long-term credit rating of A- or equivalent for the Company to enter into a new transaction.

Trade receivables predominantly relate to transportation income from gas shippers. Credit risk arising from the Group's regulated business is managed in accordance with industry standards as set out by the Unified Network Code. Credit risk on amounts receivable from other Group companies is considered minimal.

Pricing risk

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

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2022**EMPLOYEES**

The Company places considerable value on the involvement of its employees. It has continued to keep them informed on matters affecting them and on the various factors affecting the Company. Participation by employees generally is encouraged through team meetings, briefings, a digital app and an intranet site. The CEO and other senior executives regularly communicate with employees through these channels and employee representatives are consulted regularly on a wide range of matters affecting their current and future interests.

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

GOING CONCERN

The Company's accounts have been prepared on a going concern basis.

The Directors have forecast cash flows of the company for the next twelve months to 31 July 2023 (the going concern period) and have obtained a support letter from Scotia Gas Networks Limited confirming that it can and will support the Company in meeting its liabilities throughout the going concern period.

In assessing the ability of the company to rely on this support the Directors have considered the going concern assessment undertaken at the Scotia Gas Networks Limited group level, the conclusion of which is that even under severe but plausible downside scenarios there is headroom in relation to both liquidity and covenants.

Consequently, the Directors believe that the Company will be able to meet its liabilities as they fall due and will have adequate resources to continue in operational existence for twelve months (to 31 July 2023) from the date of approval of this report. Accordingly, the Directors continue to adopt the going concern basis in preparing the financial statements.

ENVIRONMENT AND SUSTAINABILITY

This year, in response to stakeholder feedback about improved governance, we have set up an Environment Advisory Panel to challenge and provide support with our sustainability strategy and action plan. The panel of industry sustainability experts will provide insight into the current and future needs of our stakeholders, customers and communities and suggest appropriate actions to improve our environmental performance. The panel is chaired by Kathryn Dapr , Head of Energy and Sustainability at NHS National Services Scotland, and includes members from our CEG and Stakeholder Advisory Panels.

Progress on targets

We are currently working with a "keep up the good work" approach, monitoring and reporting our carbon footprint, waste and the impact the business has on the environment.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report
for the Year Ended 31 March 2022

Natural gas shrinkage is made up of leakage of natural gas (which contains the greenhouse gas methane) from the network, own use of gas and theft of gas. This is the biggest part of the Group's carbon footprint accounting for 95.0% (2021: 96.8%). Reducing shrinkage therefore has the largest effect on reducing our carbon footprint. Over the year the Group have achieved a 2.3% reduction in natural gas shrinkage (2021: 3.2%) which equates to 12,353 tonnes of CO₂ equivalent (2021: 24,458). The reductions are largely achieved through our iron mains replacement programme, optimising and driving down operating pressures in the network, gas conditioning and investment and innovation.

For 2021/22 we have started to capture carbon emissions associated with waste generated in operations as per the Greenhouse Gas Protocol. This data includes waste streams from all our key activities such as reinstatement, depots, offices, Major Projects and holder demolition.

We are continuing to measure our sustainable resource use by monitoring progress against targets for spoil sent to landfill and have set a target of sending <2% spoil to landfill across our two networks.

We have carried out a Circular Economy review which explored ways of improving waste management, including spoil to landfill, and will be implementing a road map for improvement in 2022/23.

We also measure our sustainable resource use by considering the use of virgin aggregate in our reinstatement projects. By 2026, we're aiming to use no more than 0.1% virgin aggregate for reinstatement works in our Southern network and no more than 20% virgin aggregate for our Scottish network. Scotland has one of the lowest numbers of recycling centres of all gas distribution areas due to its geography and low population density, reducing our access to recycled material.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2022

The overall Carbon Footprint (compliant with Streamlined Energy and Carbon Reporting, SECR) for the Company is shown in the Table below:

	2021/22		2020/21		Annual Movement Decrease/ (increase)	
	Tonnes of CO2e	Tonnes of CO2e per £1m turnover	Tonnes of CO2e	Tonnes of CO2e per £1m turnover	Tonnes of CO2e	Tonnes of CO2e per £1m turnover
Scope 1						
Energy consumption (excluding electricity)	370	1.09	535	1.39	165	0.30
Transport (direct commercial vehicles and business miles)	8,407	24.80	5,120	13.33	(3,287)	(11.47)
Scope 2						
Electricity consumption	44	0.13	186	0.48	142	0.35
Scope 3						
Rail, air and ferry travel	4,992	14.73	3,165	8.24	(1,827)	(6.48)
Total (excluding shrinkage)	13,813	40.75	9,006	23.44	(4,807)	(17.31)
Shrinkage	190,984	563.37	198,010	515.65	7,026	(47.72)
Total carbon emissions	204,797	604.12	207,016	539.09	2,219	(65.03)

Data has not been independently verified

Energy consumption (excluding electricity) data for 2021/22 includes gas consumption by CHP associated with our Turbo Expander (which produces renewable electricity).

The significant increase in Transport and Business travel compared to 2020/21 is driven by COVID-19 restrictions no longer restricting movement.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2022**STATEMENT OF CORPORATE GOVERNANCE ARRANGEMENTS**

The Board has considered the Companies (Miscellaneous Reporting) Regulations 2018 (the 'Regulations'). Companies that meet certain thresholds are required to report under four corporate governance reporting regimes:

1. Stakeholder Engagement - A statement on how Directors have engaged with stakeholders and how Directors have had regard to stakeholder interests.
2. Corporate Governance - A statement on the Company's Corporate Governance Arrangements and how these have been applied.
3. Employee Engagement - A statement on how Directors have engaged with employees and how Directors have had regard to employee interests.
4. Section 172 - A statement on how Directors have had regard to their Section 172 duty to promote the success of the Company, as set out in the Companies Act 2006.

The Company has adopted all four of these reporting regimes (Corporate Governance Requirements). In readiness, the Company has established a governance programme to ensure Directors are able to comply with these Corporate Governance Requirements.

Internal controls in relation to the Group's financial reporting process

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

Accordingly, the Directors have regard to what controls, in their judgement, are appropriate to the business, to the materiality of the risks inherent in the business and to relative costs and benefits of implementing specific controls. Internal control is maintained through an organisation structure with clearly defined responsibilities, authority levels and lines of reporting, the appointment of suitably qualified staff in specialised business areas and continuing investment in high-quality information systems. These methods of control are subject to periodic review as to their implementation and continued suitability. There were no changes in the Company's internal controls over financial reporting during the year covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Internal audit

The Board of Directors has established the scope of the internal audit function which is responsible for reviewing the effectiveness of the Company's systems of internal control and reports to the Audit Committee of the Board. The internal audit manager reports to the Audit Committee on the audit programme, progress against the programme and any follow-up actions on a bi-monthly basis.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2022**Wates Principles**

For the year ended 31 March 2022, under the Companies (Miscellaneous Reporting) Regulations 2018, the SGN Group, including Scotland Gas Networks plc has applied the Wates Corporate Governance Principles for Large Private Companies, published by the Financial Reporting Council (FRC) in December 2018. A full copy can be viewed on the FRC's website.

The Wates Principles provide a framework for the SGN Board to monitor corporate governance of the SGN Group and see where governance standards can be raised to a higher level across the business. We believe this, in turn, will result in better engagement with our stakeholder base. The governance framework will also provide the right environment for the Board to make decisions for the long-term success of the SGN Group.

The six Wates Principles are as follows:

1. Purpose and leadership

An effective Board develops and promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose.

2. Board composition

Effective Board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual Directors having sufficient capacity to make a valuable contribution. The size of a Board should be guided by the scale and complexity of the company.

3. Director responsibilities

The Board and individual Directors should have a clear understanding of their accountability and responsibilities. The Board's policies and procedures should support effective decision-making and independent challenge.

4. Opportunity and risk

A Board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value, establishing oversight for the identification and mitigation of risks.

5. Remuneration

A Board should promote executive remuneration structures aligned to the long-term sustainable success of a company, considering pay and conditions elsewhere in the company.

6. Stakeholder relationships and engagement

Directors should foster effective stakeholder relationships aligned to the company's purpose. The Board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2022**Corporate Governance**

In the following section of the Directors' Report, we describe how we have applied the Wates Principles in line with its 'comply or explain' model and confirm full compliance with its principles for the reporting year ended 31 March 2022:

Principle 1 - Purpose and leadership

An effective Board develops and promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose.

Our purpose is to serve our communities by keeping everyone safe and warm. It's why we exist. Our values are safety, innovation, reliability, openness and respect. Our vision is to give our customers the best clean energy experience.

The Board is responsible for ensuring that values, strategy and culture are aligned with our corporate purpose. Our strategy embeds our purpose, vision and values as key elements to ensure our stakeholders' interests are central to our long-term success.

During the financial year, SGN's employees, the Executive Committee and the Board were engaged to establish the new purpose, vision and values as represented above. More than 1,300 colleagues were involved in this engagement programme. Throughout we have worked with our stakeholders to ensure we are delivering our business plan in RIIO-GD2. Looking ahead to FY21/22, we will embed our new purpose, vision and values and make sure our workplace culture is consistent with these values and our developing ESG reporting framework.

Principle 2 - Board composition

Effective Board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual Directors having sufficient capacity to make a valuable contribution. The size of a Board should be guided by the scale and complexity of the company.

The Board comprises eight Non-Executive Directors, including a separate Chair to the Chief Executive, to ensure that the balance of responsibilities, accountabilities and decision making are effectively maintained. The Chief Executive, Chief Financial Officer and Company Secretary attend each Board meeting. Two Independent Non-Executive Directors also sit on the Board of Scotland Gas Networks plc.

The Independent Non-Executive Directors bring outside experience in utilities, energy policy and finance, and provide constructive challenge and influence. The composition of the Board is partly determined by the Shareholders' Agreement, and it is considered to be in the best interests of the Group for the CEO, CFO and each shareholder to be represented at meetings. We consider that there is an appropriate combination of skills, backgrounds, experience and knowledge that promotes accountability.

Towards the end of financial year, and as a result of the share sale by SSE, ADIA and Omers, 6 new Directors have been appointed to the Board who bring a wealth of experience and come from a range of background. All new Directors have undertaken a comprehensive induction programme led by each executive team member to introduce them to SGN.

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For FY22/23 the Board remains committed to improving diversity throughout the Company in terms of gender, ethnicity, disability and age, and its People and Reward Committee and is actively engaging with the Shareholders to ensure that diversity and inclusion remains a key objective for the selection and appointment of shareholder appointed Directors.

Principle 3 - Director responsibilities

The Board and individual Directors should have a clear understanding of their accountability and responsibilities. The Board's policies and procedures should support effective decision-making and independent challenge.

The Company has a separate Chair and CEO to ensure that the balance of responsibilities, accountabilities and decision making are effectively maintained. The Board receives regular reports on financial and operational performance, customers, people and stakeholders and management of key business risks along with updates on activities and decisions of its committees. Independent Non-Executive Directors provide constructive challenge to the Boards decision-making process.

The Board continues to be supported by the work of the Board Committees. During the year, a review of the Board Reserved Matters was completed and continues to be rolled out, to ensure the balance of responsibilities, accountabilities and decision making is maintained between the Executive Committee, Board and new subsidiary companies within the Group, as the Group continues to grow and diversify.

In FY22/23, once the new Board has become fully embedded, a Board effectiveness review, will be undertaken. A review of the Board training schedule is also planned to ensure the training provided to the Board remains robust and relevant for each year and will also be aligned with any training needs identified following the outcome of the Board effectiveness review.

Principle 4 - Opportunity and risk

A Board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value, establishing oversight for the identification and mitigation of risks.

The Board seeks out opportunity while mitigating risk. Long-term strategic opportunities and high value investments are presented to the Board. The Executive Committee ensures that inherent and emerging risks are identified and managed appropriately and in a timely manner updating the risk register for any changes in underlying conditions and reporting this through to the Board. Operational and safety risks are regularly reviewed by the Risk and Resilience Committee and financial risks by the Audit Committee.

The Board formally reviewed and challenged the key strategic risks both at the half and full year point. This encompassed a formal review of emerging risks taking insights from independent sources to help shape this discussion. The Board reviewed the risk appetite and target risks in FY21/22 to ensure these reflect the RIIO-GD2 plan and pathway to decarbonisation. The Board also reviewed key investment opportunities.

In FY 22/23 key strategic risks are again on the Board Agenda at both the half and full year points and key investment opportunities will continue to be reviewed by the Board throughout the year. The Group risk management framework is being reviewed in 22/23 and any key changes proposed to the framework will be considered and agreed by the Board.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2022**Principle 5 - Remuneration**

A Board should promote executive remuneration structures aligned to the long-term sustainable success of a company, considering pay and conditions elsewhere in the company.

The People and Reward Committee has clearly defined terms of reference and is responsible for making recommendations to the Board concerning the Group's remuneration strategy, recruitment framework and long-term incentive plans for senior executives. The Committee takes advice from independent external consultants who provide updates on legislative requirements, best market practice and remuneration benchmarking. The primary objective is to set remuneration at a level that will enhance the Group's resources by securing and retaining quality people who can deliver our Strategic Pillars and long-term value for its existing and future customers, stakeholders and shareholders.

In FY21/22, the Board (following a recommendation from PARCO) approved the annual salary review of all employees for cost of living and agreed to proposed changes to both the short-term and long-term incentive plan framework for the Financial Year ensuring these measured both the financial and non-financial performance. The Board also approved a thank you payment to all employees (excluding the Executive) for their commitment and hard work during Covid-19.

In FY22/23 with the support of PARCO the Board is committed to ensure the talent and succession for the Group's Executive is suitable for the group's long-term success and diversity and inclusion plays a key role across the Group. A Talent Review is planned and will be combined with diversity and inclusion data. This will then be used to feed into the review of the remuneration for key talent.

Principle 6 - Stakeholder relationships and engagement

Directors should foster effective stakeholder relationships aligned to the company's purpose. The Board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions.

The Board is aware of the broader impact it has on its various environments, its customers and society in general, and has established corporate social responsibility policies and practices for the Group. The Board is committed to social responsibility, community engagement and environmental sustainability as underpinned by our strategic priorities.

Our priority during this year has been our continuing focus on our core purpose, to keep everyone safe and warm, with the carbon impact of the gas network and creating a sustainable future for the business also becoming increasingly important priorities. Regular two-way engagement with our stakeholders has been central to this, and their feedback continues to shape our decision-making.

Our stakeholder, Environment and Customer Committee (SECC) continued to meet during the year, taking account of stakeholder feedback and insight as they continued in their commitments to decarbonise the gas network and further develop our ESG strategy and reporting framework.

We will continue to build our engagement by agreeing a formal, but dynamic, Board stakeholder engagement plan to ensure we continue to foster relationships and put stakeholders at the heart of how we deliver our business.

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Directors' Report for the Year Ended 31 March 2022

Chair

Our Board is led by our Chair, Nick Salmon, who was appointed on 1 March 2021 and is responsible for the effective running and management of the Board. The roles of Chair and Chief Executive Officer are separate, with clear divisions of responsibilities.

Board of Directors

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

The Board is collectively responsible for the long-term success of the Company and for setting of a clear purpose, vision and sustainable strategy which creates value for existing and future customers, stakeholders and shareholders. It provides the leadership necessary for the Company to meet its business objectives while ensuring a sound system of internal control and risk management is in place. The powers and the duties of the Directors are determined by legislation and by the Company's Articles of Association. The Board has also adopted a formal schedule of matters detailing key aspects of the Company's affairs reserved to it for decision.

Board constitution and appointments

The Board of Directors comprises eight Non-Executive Directors. This consists of a Non-Executive Chair and seven Non-Executive Directors.

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

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

Roles and responsibilities for each Board Member, Chief Executive Officer, Chief Financial Officer and Group Company Secretary can be found on page 41 followed by their biographies on page 51.

Board Committees

During the year the Board was directly assisted in the discharge of its duties by five Board Committees and dedicated GD2 Board meetings, whose remit, authority and composition are monitored to ensure continued and appropriate Board support.

Each of the Board Committees provides dedicated focus to a defined area of responsibility. Board Committees act as an advisory body, with the Board retaining oversight and final decision making, except where otherwise delegated by the Board in which case the Committee will act within their agreed authority.

Board Committee membership is determined by the Board. Prior to determining membership, the Board will consider the subject matter of the Committee's purpose and duties to ensure that the membership addresses its specific needs. Membership will assess technical skills, knowledge and experience whilst recognising the benefits associated with diversity. Each Board Committee is chaired by a Non- Executive Director.

Further information on the Board committees is set on pages 42 to 50.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2022**Board effectiveness**

The Group Company Secretary, Chief Executive Officer and Chair conducted a governance review and gathered Board feedback on its effectiveness including areas such as Board paper quality, timeliness, Board meetings and engagements for the financial year. From this, a governance action plan for 2021/22 had been developed focusing on areas of continuous improvement for the Board. As part of this, the Board had a strategy day which focused on unregulated growth and energy transition arrangements.

Chief Executive Officer and Chief Financial Officer

Below the Board, executive responsibility rests with John Morea, Chief Executive Officer (CEO) and Mick Carmedy, Chief Financial Officer (CFO). The CEO and CFO are each employed by the Group and are not Directors of the Company although attend each Board meeting. They are supported by the Executive Committee.

Executive Committee

Day-to-day management of the Company is delegated to the Executive Committee which meets monthly and is chaired by the Chief Executive Officer and whose membership includes the Chief Financial Officer and leaders of each business unit. The Executive Committee is in turn supported by its own operational and assurance framework with defined roles and responsibilities including relevant delegated authorities.

Board and Executive Reporting

To ensure that all decision making is well-informed, transparent and balanced, careful consideration is given to information provision and flows within the governance framework. During the year the Group Company Secretary worked with Board Intelligence Limited to provide refresher training to Board and Committee paper authors on best practice paper writing to support the provision of high-quality information and effective decision making. This exercise involved reinforcing the use of best practice paper templates which seek to help focus the Board on what matters (including checks against their Section 172 duties). Refresher training on dashboard reporting (displaying key performance data and rapid insights on the overall health of the Company) was also provided to streamline reporting across the Group at a Committee level. Board information is distributed digitally, instantly and securely via the Board Intelligence platform once available.

The Group Company Secretary is responsible to the Board for the timeliness and quality of information. All Directors have access to the advice and services of the Group Company Secretary.

Conflicts of interest

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

In addition, conflicts of interest and governance are included as standing agenda items for every Board Meeting. The Group Company Secretary periodically reviews the Board protocols and governance framework to confirm that they remain fit for purpose and considers any initiatives which could strengthen the governance of the Company and decision making.

Shareholders

SGN has three supportive shareholders. The Board interacts with the shareholder members on a regular basis and always acts fairly with members of the Company.

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Directors' Report for the Year Ended 31 March 2022

Board Meetings

There were six scheduled meetings of the Board in the year and three further Board calls in line with the agreed plan of business for the year, and details of Director attendance can be found on page 49.

In the months between full Board meetings, a Board update call provides the opportunity to discuss key business developments, and emerging issues and opportunities, with arrangements also in place should a Board decision or approval be required outside of the above times. In total there were nineteen Board meetings and calls during the year.

Scheduled meetings of the Board follow an agreed format, with agendas being developed from the Board's annual plan of business and tailored to reflect the current status of projects, strategic workstreams and the overarching operating context. Finalisation of meeting content is a collaborative process involving the Chair, Chief Executive, Chief Financial Officer and the Group Company Secretary, who ensure adequate time is allocated to support effective and constructive discussion.

Board engagement out of the Boardroom

The Board also ensures it spends time out of the Boardroom with stakeholders. During the year the Board was impacted by what physical engagement it could undertake due to social distancing, however the Board were able to undertake an employee engagement session with a number of employees towards the end of the year. The Board plans to resume stakeholder engagement sessions going forward.

Board activity

The Board splits its time between steering and supervising the organisation across strategy, performance and governance. With Board input, the Group Company Secretary has developed a focused set of priorities for the Board for the year. The aim of developing priorities is to ensure the right items come to the Board at the right frequency to help focus on the issues that matter most to the Company and ensure meeting time is used effectively. The supporting Board papers for each agenda item focus on answering the key questions on the Board's mind. In line with the Board's responsibility for the overall strategic direction of the Company, strategy related issues are discussed at every Board meeting.

During the year the Board spent a significant time considering its strategy over the next five years as part of the ongoing RIIO-GD2 as the outcome of the CMA appeal was awaited.

As part of this, the Board has overseen a number of other strategy-related analyses, including, but not limited to: a review of SGN's pathway to the decarbonisation of heat, covering relevant trends in policy, technology, customer and stakeholder expectations; SGN's long-term financial outlook; assessment and prioritisation of growth opportunities; and a review of SGN's key risks.

Further details of the areas which have shaped the Board and Committee agendas during 2021/22 are set out below:

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Board Focus Detailed description

Strategy

Development and decision to appeal Final Determination by Ofgem: extensive review and analysis.

Transformation: review of transition plans into GD2 to ensure ability to meet regulatory outputs and financial metrics.

Stakeholders: review of engagement with energy policy holders on various topics.

People and Culture: consideration and approval of the Group's refreshed purpose, vision and values, including a review of the summarised research (Executive Team workshops, employee focus groups, one to ones and online surveys).

Cyber Security & IT Resilience: reviewed IT resilience across the business and approved the cyber security policy, assessment framework and investment programme.

Commercial Strategy: reviewed the Commercial strategy covering the strategic framework, non-regulated activities, delivery of strategy and future developments.

SG Reporting Framework: review and approval of adopting the World Economic Forum's Stakeholder Capitalism Metrics as the Company's ESG reporting framework.

Decarbonisation of Heat Strategy: reviewed the Group's strategy and progress with decarbonisation of heat including. Approved various energy futures and net-zero projects connected with the development of the strategy.

Supplier of Last Resort & Tariffs: consideration and approval of the supplier of last resort strategy and tariffs.

Customer: review and support of the GD2 customer strategy to ensure ability to meet GD2 business plan requirements and maintain positive customer experience.

Share Sale: review of the transaction progress against the project timeline, process and approval of the sale transaction.

Performance

Financial: review of long-term financial outlook and performance including consideration of dividend proposals, sufficient resources and approval of annual budget.

Regulatory: continued Board focus and review of regulatory performance and initiatives and close out of.

Safety performance: continued Board focus and review of safety performance and initiatives, including Board site visits.

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Board focus Detailed description

Stakeholder: continued Board focus and review of stakeholder performance and initiatives, including employee engagement session.

Operations & Network: Deeper review of Southern & Scotland Operations and Network performance and initiatives.

Cyber: focussed review and assurance.

Governance

Strategic risks: consideration of strategic risks and implementing appropriate governance, monitoring compliance and ongoing risk management.

Contract strategy and approvals: various significant contracts, including strategies, considered pursuant to the Board schedule of reserved matters.

Policies and certificates: approved various Group policies and compliance certificates in line with the Governance Framework, such as modern slavery.

Annual Report & Accounts: approval of annual report and accounts prior to submission to the annual general meeting.

Governance: review of Board committee membership, effectiveness, reporting, priorities and planning and compliance with the Corporate Governance requirements.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2022**SGN Board Roles and Responsibilities**

The below role specifications set out the clear division of responsibility between members of the Board and ensure adequate focus on areas central to its role.

Position	Responsible for:
Chair	<p>Leading the effective operation and governance of the Board:</p> <ul style="list-style-type: none"> - Setting agendas which support efficient and balanced decision-making. - Ensuring effective Board relationships and a culture that supports constructive discussion, challenge and debate. - Ensuring Board members are aware of and understand the views of key stakeholders. - Creating the conditions for overall Board effectiveness.
Chief Executive Officer	<p>Proposing and directing the delivery of strategy as agreed by the Board:</p> <ul style="list-style-type: none"> - Leadership and day-to-day management of the Group and Executive Committee. - Engaging with SGN's six key stakeholder groups and leading on related activity.
Chief Financial Officer	<ul style="list-style-type: none"> - The financial performance of the Group and supporting the Chief Executive Officer in implementing strategy. - Proposing policy and actions to support sound financial management. - Leading on unregulated activities. - Overseeing relationships with debt investors.
Non-executive Shareholder Directors	<ul style="list-style-type: none"> - Providing constructive challenge to the Board's decision-making processes. - Scrutinising, measuring and reviewing the performance of the Group. - Constructively challenging and assisting in the development of strategy. - Reviewing and challenging the performance of the Group's business against stakeholder interest.
Independent Non-executive Directors	<p>Same responsibilities as Non-Executive Shareholder Directors, with the addition of:</p> <ul style="list-style-type: none"> - Bringing independence to the Board and its decision-making process. - Providing independent insight and support based on relevant experience. - Assessing risk and the integrity of the financial information and controls. - Providing independent input into the Group's strategy to reflect stakeholder interests.
Company Secretary	<ul style="list-style-type: none"> - Compliance with Board procedures and supporting the Chair. - Ensuring the Board has high quality information, adequate time and the appropriate resources. - Advising and keeping the Board updated on corporate governance developments. - Considering Board effectiveness in conjunction with the Chair. - Facilitating the Directors' induction programmes and training. - Providing advice, services and support to all Directors as and when required.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
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The Board Committees convene to steer and supervise the SGN Group across strategy, performance and governance in the short, medium and long-term. As Scotland Gas Network plc is one of the main trading entities of the SGN Group, a significant amount of the Board Committees focus is directed towards the Company. The Committee's company-related activities are introduced below.

Audit Committee**Membership**

The current members of the Audit Committee are Paul Jeffery (Committee Chair), Nick Salmon, Michael Botha and Martin Catchpole.

Attendees

The External Auditors are invited to attend the Audit Committee along with the Chief Financial Officer, the Head of Internal Audit & Compliance, the Group Financial Controller and the Group Accounting Manager who represent Management.

The role of the Committee and principal responsibilities

The Audit Committee is a sub-committee of the Board. The Committee's role is to support the Board within the Governance Framework in matters relating to the: integrity of Financial Reporting; relationship with the External Auditor and the effectiveness of the external audit process; effectiveness of the Internal Audit and Compliance

function; and effectiveness of the System of Internal Control. The Audit Committee also reviews key regulatory filings prior to submission to Ofgem.

What the Committee has done this year

The Audit Committee held three meetings during the financial year which were scheduled in advance of Board meetings. This enabled the Chair to report on key matters discussed to the Board and, where required, recommend decisions to be ratified by the Board in line with the Committee Terms of Reference.

Key highlights

The key highlights for the year were:

Financial reporting

- Reviewed and considered key accounting judgements, the interim and final financial results and recommended the same for approval by the Board for the annual results for the statutory and regulatory accounts.
- Reviewed the carrying value of goodwill and the assessment of impairment indicators.

External audit

- Reviewed and considered the re-appointment of external auditor, Ernst & Young LLP.
- Monitored the independence of the external auditor.
- Reviewed the effectiveness of the external audit process and considered market trends and impacts.
- Considered the accounting, financial control and audit issues from the external auditor's report.

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Internal audit

- Reviewed the outputs from the internal audit benchmarking against the Internal Auditors (IIA) Code of Practice and approved changes to the Internal Auditor Charter.
- Reviewed the annual audit plan, recommended the same for approval by the Board and received regular updates on the delivery of the plan.

Risk management and internal controls

- Reviewed the annual compliance plan, recommended the same for approval by the Board and received regular updates on the delivery of the plan.
- Reviewed key outcomes of all internal compliance investigations, including incidents raised via 'speak up' channels to help assess risks, trends, and culture across the Group.
- Received the external compliance report on compliance with Standard Special Condition A33 concerning business separation and recommended the same for approval by the Board prior to submission to Ofgem.

Regulatory filings and governance

- Reviewed the debt to RAV and compliance certificates for Scotland Gas Networks PLC and Southern Gas Networks PLC and recommended the same for approval by the Board.
- Reviewed the financial compliance certificates for the MidCo Group and recommended the same for approval by the Board.
- Monitored the level of non-audit fees, reviewed new non-audit services and recommended the same for approval by the Board.
- Received regular reports on Ofgem filings made.

Looking forward

The Committee's priorities for FY22/23 are continuing to develop and improve our internal controls and assurance processes, with input from our internal and external auditors and with consideration to the BEIS proposals for UK audit reform (if and when these are progressed by the Government). An annual internal audit to assess the new GD2 reporting requirements is also planned for 2022/23.

Health and Safety Committee

Membership

The current members of the Health and Safety Committee are Nick Salmon (Committee Chair), Laura Sandys, Rebecca Lumlock and Paul Trimmer.

Attendees

The Chief Executive Officer, the Network & Safety Director and the Group Head of Safety & Environment also attend the Health and Safety Committee meetings to represent Management.

The role of the Committee and principal responsibilities

The Health and Safety Committee ('HSC') is a subcommittee of the Board and acts as a scrutineer to ensure the processes for managing health and safety risks are robust. This is delivered through four principles for effective leadership in health and safety; Plan, Do, Check and Act.

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- Plan - set the direction through approving effective health and safety policies; and set health and safety targets across a range of metrics covering members of public, staff and operational activities.
- Do - monitoring the execution of those policy statements; reviewing and challenging performance against targets; and reviewing compliance and assurance plans, monitoring progress against key safety programmes.
- Check - comprehensive health and safety report for the Committee; safety performance review and key updates in the CEO report; and significant incident notifications from the CEO.
- Act - annual review of health and safety at the Committee; Board members and Executive team site safety visits; and update on external audit reports to provide the Committee with assurance.

What the Committee has done this year

The Health and Safety Committee held four meetings during the financial year, which were scheduled in advance of Board meetings. This enabled the Chair to report on key matters discussed to the Board and, where required, recommend decisions to be ratified by the Board in line with the Committee Terms of Reference.

Key highlights

The key highlights for the year were:

Performance

- Reviewed and approved the Health and Safety targets across a range of metrics.
- Monitored and challenged performance and progress against the Health and Safety targets and scrutinised delivery plans.
- Reviewed compliance and assurance plans, including external assurance activity.
- Reviewed the Group's winter readiness and road traffic improvement plan.
- Received an update on the 3-yearly review of the safety case.

Governance

- Reviewed and approved the Safety, Health and Environment Policy statement for FY21/22.
- Reviewed and agreed changes to the Committee terms of reference.

Strategy

- Reviewed the continued impact of Covid-19 on safety performance.
- Reviewed the project to update and transform the safety management framework.

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Looking forward

The Committee has undertaken a review of its roles and responsibilities to reflect the structural changes at Board Committee level and will be implementing changes accordingly for FY22/23. The Committee's priorities for FY22/23 are continuing to drive health and safety improvements ensuring that the Group achieves its commitment to getting everyone home safe and well. FY22/23 will continue to see increased focus on safety culture and a drive in reporting and performance improvements for mental health and wellbeing. A commitment across the Group for visible leadership through site engagements post the Covid-19 pandemic will also be implemented.

People and Reward Committee

Membership

The current members of the People and Reward Committee are Charlotte Brunning (Committee Chair), Rebecca Lumlock, Paul Trimmer and Laura Sandys.

Attendees

The Chief Executive Officer, the HR & Services Director and the Head of Employee Relations, Policy & Rewards also attend the People and Reward Committee meetings to represent Management.

The role of the Committee and principal responsibilities

The People and Reward Committee is a sub-committee of the Board. The People and Reward Committee's role is to support the Board by ensuring:

- remuneration policy and practices of the Company reward fairly and responsibly, with a clear link to corporate and individual performance, having regard to statutory and regulatory requirements;
- talent and succession strategy for the Group's Executive is suitable for the group's long-term success;
- diversity and inclusion plays a key role across the group; and
- employee feedback is listened to and acted on.

What the Committee has done this year

The Committee held five meetings during the financial year, which were scheduled in advance of Board meetings. This enabled the Chair to report on key matters discussed to the Board and, where required, recommend decisions to be ratified by the Board in line with the Committee Terms of Reference.

Key highlights

The key highlights for the year were:

Strategy

- Reviewed the short-term incentive plan (STIP) and long-term incentive plan (LTIP) framework for the Financial Year ensuring these measured both financial and non-financial performance.

Performance

- Approved the performance assessments for STIP and LTIP for the prior Financial Year.
- Considered impacts and adjustments to the LTIP for the year given the ongoing impact of Covid-19.

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- Reviewed and approved personal objectives for the Chief Executive Officer and Chief Financial Officer and assessed prior year performance.
- Considered impacts and adjustments to the LTIP for the year given the ongoing impact of Covid-19.

Governance

- Reviewed the Diversity & Inclusion Strategy.
- Received an update regarding the pay deal to be discussed with the Trade Unions.
- Reviewed the Committee's effectiveness and terms of reference.
- Monitored the recruitment process and appointment of the new Director of Operations (South).

Looking forward

The People & Reward Committee was renamed the Remuneration Committee as of 25 May 2022. The Committee's priorities for FY22/23 are to ensure the talent and succession strategy for the Group's Executive is suitable for the group's long-term success and diversity and inclusion plays a key role across the group. The Committee has undertaken a review of its roles and responsibilities to reflect the structural changes at Board Committee level and will be implementing any changes accordingly for FY22/23. The Committee will also review feedback from employees taking part in the Company's bi-annual employee engagement survey and monitor performance against an approved action plan.

Finance Committee

Membership

The current members of the Finance Committee are Charlotte Brunning (Committee Chair), Paul Jeffery, Martin Catchpole and Michael Botha.

Attendees

The Chief Financial Officer and Group Treasurer also attend the Finance Committee meetings to represent Management.

The role of the Committee and principal responsibilities

The Finance Committee is a sub-committee of the Board.

The Finance Committee's role is to support the Board by determining:

- distribution proposals and strategy including forecast distributions;
- financing and refinancing strategy and proposed debt issuance;
- financial risk management strategy;
- credit rating strategy;
- a policy concerning the operation of bank accounts and facilities, including appointment of authorised personnel to those accounts and facilities; and

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- a policy of granting guarantees, indemnities, any type of parent-company support or security interest. In addition, the Finance Committee will review and approve investments or transactions where the Committee has been delegated authority by the Board to do so.

What the Committee has done this year

The Finance Committee held five meetings during the financial year of which two were additional to the original schedule. The Chair reports on key matters discussed to the Board and, where required, recommends decisions to be ratified by the Board in line with the Committee Terms of Reference.

Key highlights

The key highlights for the year were:

Strategy

- Reviewed Inflation and Interest Rate risk management plans for the group and confirmed support for execution of CPI-linked swaps and liability management of existing interest rate swaps to manage these risks.
- Reviewed Funding plans for the Company and confirmed support for execution of a new £100m CPI-linked loan facility.
- Received regular updates on the proposed changes to the Company's defined pension scheme, including feedback received from Ofgem.

Governance

- Reviewed plan for transitioning LIBOR based instruments to SONIA and recommended the same for approval by the Board.
- Reviewed the Company's Financial Risk Management strategy and recommended the same for approval by the Board.
- Reviewed the Funding Strategy and distribution proposals and recommended the same for approval by the Board.
- Reviewed defined benefit scheme valuation and engagement and recommended the same for the approval by the Board.

Looking forward

The Committee's priorities for FY22/23 are to monitor the implementation of funding and financial risk management strategies approved in FY21/22 to ensure the group has appropriate management of financial risk and that credit ratings are maintained within target levels. The Committee will also be focused on the refinancing of the upcoming funding maturities within to ensure that these are managed to maintain an appropriate funding profile and liquidity position.

Stakeholder, Environment and Customer Committee

Membership

The current members of the Stakeholder, Environment and Customer Committee are Laura Sandys (Committee Chair), Rebecca Lumlock, Paul Trimmer and Charlotte Brunning.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report for the Year Ended 31 March 2022

Attendees

The Chief Executive Officer and the Director of Stakeholder and Communications also attend the Stakeholder, Environment & Customer Committee meetings to represent Management.

The role of the Committee and principal responsibilities

The Stakeholder, Environment and Customer Committee is a sub-committee of the Board. The Stakeholder, Environment and Customer Committee's principal role is to ensure the Company has due regard to:

- stakeholder, environmental and customer (SEC) interests;
- the need to foster relationships with suppliers, customers and others; and
- the Company's impact (including the impact of any principal decisions taken by the Group) on the broader community and environment.

The Committee also supports with Board oversight for the identification of stakeholder, environmental and customer opportunities and risks and emerging Environmental, Social and Governance issues.

What the Committee has done this year

The Stakeholder, Environment and Customer Committee held three meetings during the financial year, which were scheduled in advance of Board meetings. This enabled the Chair to report on key matters discussed to the Board and, where required, recommend decisions to be ratified by the Board in line with the Committee Terms of Reference.

Key highlights

The key highlights for the year were:

Strategy

- Reviewed and recommended to the Board the approval of the Company's revised Purpose, Vision and Values.
- Reviewed and recommended to the Board the approval of the Company's adoption of the World Economic Forum's Stakeholder Capitalism Metrics ESG Framework ('WEF').
- Received an overview of the political environment and the Company's planned activities for the calendar year and provided feedback.
- Received the customer engagement strategy for the H100 Fife project and provided feedback.

Performance

- Reviewed performance of the Company's stakeholder, environment and customer engagement activities and provided feedback.
- Reviewed the progress against the Company's Vulnerable Customer Ambition
- Reviewed performance against the ESG reporting programme.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2022

- Received an overview on the role of the Stakeholder Advisory Panel and an update of matters discussed at the Vulnerability Stakeholder Group.
- Reviewed performance against the GD2 reporting requirements and close out of GD1.
- Received oversight and assurance on the strategic risks falling within the Committee's remit.
- Discussed the Board and Employee Engagement session conducted.

Governance

- Reviewed the Committee's effectiveness and terms of reference.

Looking forward

The Stakeholder, Environment and Customer Committee was renamed the Environmental, Social & Governance Committee as of 25 May 2022. The Committee has undertaken a review of its roles and responsibilities to reflect the structural changes at Board Committee level and will be implementing changes accordingly for FY22/23. The Committee's priorities for the next financial year will include a review of ESG risks which fall within the Committee's remit, select and recommend to the Board a cohesive set of ESG related reporting metrics.

Attendance at Board and Board Committee meetings

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

	Board meetings		Audit Committee meetings		People and Reward Committee meetings (PARCO)	
	Attended	Possible	Attended	Possible	Attended	Possible
Gregor Alexander - 1	7	9	2	3	4	5
Charlotte Brunning	9	9	-	-	5	5
Michael Botha - 2	1	9	1	3	-	-
Martin Catchpole - 3	1	9	1	3	-	-
Adam Friedrichsen - 4	6	9	1	3	-	-
Paul Jeffrey	8	9	3	3	-	-
Guy Lambert - 5	5	9	2	3	4	5
Rebecca Lumlock - 6	1	9	-	-	1	5
Robert McDonald - 7	8	9	-	-	-	-
Michael McNicholas - 8	8	9	-	-	4	5
Felipe Ortiz - 9	1	9	-	-	-	-
Nicholas Salmon	9	9	3	3	5	5
Laura Sandys	7	9	-	-	-	-
Paul Trimmer - 10	1	9	-	-	-	-
Delphine Voeltzel - 11	1	9	1	3	-	-
Alternate Directors						
Charles Thomazi - 12	0	9	0	3	0	5
Henrik Onarheim - 13	2	9	1	3	0	5

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2022

	Health and Safety Committee meetings		Stakeholder, Environment and Customer Committee meetings		Finance Committee meetings	
	Attended	Possible	Attended	Possible	Attended	Possible
Gregor Alexander - 1	-	-	-	-	4	5
Charlotte Brunning	-	-	3	3	4	5
Michael Botha - 2	-	-	-	-	-	-
Martin Catchpole - 3	-	-	-	-	-	-
Adam Friedrichsen - 4	-	-	1	3	3	5
Paul Jeffrey	-	-	-	-	4	5
Guy Lambert - 5	1	4	0	3	1	5
Rebecca Lumlock - 6	1	4	-	-	-	-
Robert McDonald - 7	3	4	2	3	-	-
Michael McNicholas - 8	3	4	2	3	-	-
Felipe Ortiz - 9	-	-	-	-	-	-
Nicholas Salmon	4	4	-	-	-	-
Laura Sandys	4	4	3	3	-	-
Paul Trimmer - 10	1	4	-	-	-	-
Delphine Voeltzel - 11	-	-	-	-	1	5
Alternate Directors						
Charles Thomazi - 12	0	4	0	3	0	5
Henrik Onarheim - 13	0	4	3	3	2	5

Notes to the tables above:

- 1 - Gregor Alexander resigned from the Board and stepped down from Audit Committee, Finance Committee, PARCO on 22 March 2022
- 2 - Michael Botha was appointed to the Board, Audit Committee and Finance Committee on 22 March 2022
- 3 - Martin Catchpole was appointed to the Board, Audit Committee and Finance Committee on 23 March 2022
- 4 - Adam Friedrichsen resigned from the Board and stepped down from the Audit Committee, Finance Committee and SECC on 23 March 2022
- 5 - Guy Lambert resigned from the Board and stepped down from the Audit Committee, Finance Committee, Health & Safety Committee and PARCO on 22 March 2022
- 6 - Rebecca Lumlock was appointed to the Board, Health & Safety Committee, People and Reward Committee and Stakeholder, Environment & Customer Committee on 22 March 2022
- 7 - Robert McDonald resigned from the Board and stepped down from the Health & Safety Committee and SECC on 22 March 2022
- 8 - Michael McNicholas resigned from the Board and stepped down from the Health & Safety Committee, PARCO and SECC on 23 March 2022
- 9 - Felipe Ortiz was appointed to the Board on 22 March 2022
- 10 - Paul Trimmer was appointed to the Board, Health & Safety Committee, People and Reward Committee and Stakeholder, Environment & Customer Committee on 23 March 2022
- 11 - Delphine Voeltzel resigned from the Board and stepped down from the Audit Committee and Finance Committee on 1 July 2021
- 12 - Charles Thomazi is an alternate director to Charlotte Brunning
- 13 - Henrik Onarheim is an alternate director to Guy Lambert. Resigned from the Board on 22 March 2022.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2022**Directors' and Senior Executives' Biographies and Responsibilities as at 31 March 2022****Nick Salmon, Chair, Non-executive Director**

Nick joined the Board in March 2019 and was appointed the Chair of SGN in March 2021. He is also the Chair of Pressure Technologies plc. Previously he was Chair to South East Water Ltd, the Senior Independent Director at both United Utilities plc and Elementis plc, a non-executive Director at Interserve plc and CEO of Cookson Group plc and Babcock International Group plc. Nick is member of the Audit Committee and is the Chair of the Health and Safety Committee.

Charlotte Brunning, Non-executive Director

Charlotte joined the Board in May 2018. She is a member of the EMEA Infrastructure and Natural Resources team and had been with Ontario Teachers' since 2015. She has been involved in a number of direct investments, including London City Airport, ADNOC, SGI and SGN Smart. Charlotte holds a B.Sc. from the London School of Economics and an MBA from the London Business School. Charlotte is also director of Galaxy Pipeline Assets Topco Limited, Apple Newco Limited and SGI. Charlotte serves as the Chair of the Finance Committee and the People and Reward Committee. She is also member of the Stakeholder, Environment and Customer Committee.

Martin Catchpole, Non-executive Director

Martin joined the Board in March 2022 and is a Principal at Global Infrastructure Partners ('GIP') focusing on its energy and utility infrastructure investments across EMEA. Previously, he spent 16 years at Credit Suisse where he most recently was Co-Head of the Energy Group and Investment Banking. Martin is also a Chartered Accountant, qualifying with EY prior to his career in investment banking. Martin is also a director of Galaxy Pipeline Assets HoldCo Limited. Martin is member of the Audit Committee and the Finance Committee.

Paul Trimmer, Non-executive Director

Paul joined the Board in March 2022 and is a Senior Advisor to Global Infrastructure Partners ('GIP') focusing on its energy sector. He has been a Board Director of FluxSwiss, CLH-PS and Interconnector UK and is an Advisory Board Member for Carbon Connect (an entity supporting the UK's transition to Net Zero). Previously, Paul spent 32 years in Shell, including as an Executive Director of Comgas and Transredes. Paul is also a Partner in Atosú. Paul is member of the People and Reward Committee, the Health and Safety Committee and the Stakeholder, Environment and Customer Committee.

Michael Botha, Non-executive Director

Michael joined the Board in March 2022 and is a Managing Director in Brookfield's Infrastructure Group overseeing operations, risk management and asset management activities. He has held senior positions across the organisation, including the Chief Risk Officer in Brookfield's Infrastructure Group, COO and CFO of Brookfield's private infrastructure funds business. Prior to joining Brookfield, Michael worked in the audit practice of a Big Four accounting firm. Michael is member of the Audit Committee and the Finance Committee.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2022**Rebecca Lumlock, Non-executive Director**

Rebecca joined the Board in March 2022 and is an Operating Partner in Brookfield Asset Management. Prior to this she was the Group Transformation Director for Network Rail and before that, the Managing Director for the Wessex Route, including London Waterloo. She was also their Group executive sponsor for gender. Rebecca has worked in the oil and gas industry for over 20 years across four continents, most recently as Managing Director of Dragon LNG, importing liquefied natural gas from around the world to help satisfy the UK's gas demand. Rebecca is also director of UK Gas Distribution 2 Limited, Galaxy Pipeline Assets Holdco Limited and PD Ports Limited. Rebecca is member of the People and Reward Committee, the Health and Safety Committee and the Stakeholder, Environment and Customer Committee.

Felipe Ortiz, Non-executive Director

Felipe joined the Board in March 2022 and is a Managing Director in Brookfield's Infrastructure Group. Since joining Brookfield in 2009, he has led multiple infrastructure investments in utilities globally. Previously Felipe worked in a New York investment bank, providing advisory to infrastructure investors. Felipe holds and MSc from the Stanford Graduate School of Business and a BEng from Universidad de los Andes. Felipe is also a director of UK Gas Distribution 2 Limited, Galaxy Pipeline Assets Holdco Limited and Brookfield Infrastructure Limited UK.

Christian Fingerle, Non-executive Director

Christian joined the Board in May 2022 and is a Senior Managing Director with the StepStone Group. Previously, he was a Member of the Management Board and Chief Investment Officer for Infrastructure at Allianz Capital Partners, responsible for a significant direct and indirect infrastructure investment program and where he also held various board roles in portfolio companies. Prior to this, Christian worked in various roles within the Allianz Group and Technische Universitaet Muenchen.

Charles Thomazi, Alternate Director

Charles joined the board in October 2017 and leads the EMEA Infrastructure team in Teachers' Infrastructure Group. He attends board meetings as a substitute to Charlotte Brunning. Charles is Director of Ontario Teachers' Pension Plan (OTPP), Galaxy Pipelines Asset TopCo Limited, Apple NewCo Limited, Sauna HoldCo Limited and related entities and Western TopCo Limited.

Michael Smart, Alternate Director

Michael is a member of the infrastructure and real assets team at StepStone. Prior to joining Stepstone, Michael was a Director in KPMG's Infrastructure Advisory Group, where he led the Energy Transition Strategy team. Michael was previously at National Grid in a variety of roles across operations, strategy, investor relations and M&A.

Jeff Rosenthal, Alternate Director

Jeff Rosenthal is a Managing Director and Operating Partner in Brookfield's Infrastructure Group. He also provides risk management, capital expenditure and ESG oversight as the group's Chief Risk Officer.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2022**Paul Jeffery, Statutory Independent Non-Executive Director**

Paul joined the Board in January 2014. Previously he ran the European Power, Utility and Infrastructure Investment Banking Sector team for Barclays. Non-Executive Director of London Power Networks Ltd, South-Eastern Power Networks Ltd, Eastern Power Networks Ltd and UK Power Networks (IDNO) Ltd all forming part of the UK Power Networks group. Paul is the Chair of the Audit Committee and a member of the Finance Committee.

Laura Sandys, Statutory Independent Non-Executive Director

Laura joined the board in October 2018. She was a member of the Energy and Climate Change Select Committee and co-founder of POWERful Women which promotes the role of women in the energy sector. She has been appointed a member of the Government's CCUS Council and is a Member of Imperial College's Centre for Carbon Capture and Storage Advisory Group. Laura is Co-ordinator for the Reshaping Regulation Programme with Imperial College and Energy Systems Catapult, Non-Executive Director of Energy System Catapult Limited, Chair for the Energy Digitalisation Taskforce and Non-Executive Director for Highview Power. Laura serves as the Chair of the Stakeholder, Environment and Customer Committee and she's also member of the People and Reward Committee and the Health and Safety Committee.

John Morea, Chief Executive Officer

John joined the Company in June 2005 from SSE plc. He has over 43 years' experience in the energy industry. John is a companion of the Institute of Gas Engineers and Managers, a member of the Institute of Engineering and Technology and holds an MBA. John is also a Non-executive Director of Thames Water Utilities Limited, Director of Energy Networks Association Limited and is member of the EU Skills Council.

Mick Carmedy, Chief Financial Officer

Mick joined the Company in January 2018. Mick was CFO of Southern Water, the regulated water business, for five years prior to joining. Mick has also worked at United Utilities and Thames Water in a wide variety of financial, commercial and regulatory roles. Mick is also Director of Murphy Asset Services Limited.

Nicola Shand, Director of Legal Services, Company Secretary

Nicola joined the Board as Company Secretary in July 2011. At the time of publication Nicola is on maternity leave and Sharmila Sylvester is the Interim Group Counsel and Group Company Secretary.

Sharmila Sylvester, Deputy Company Secretary and Interim Group Company Secretary

Sharmila joined the Company in 2016 and the Board as Deputy Company Secretary and Interim Group Company Secretary in December 2021. Prior to joining the Company, Sharmila was at Bombardier Transportation holding various positions including Company Secretary for the UK entities.

DISCLOSURE IN THE STRATEGIC REPORT

Details on how the Directors have had regard to the need to foster the Company's business relationships with suppliers, customers and others, and the effect of that regard on the principal decisions taken by the Company during the financial year can be found in the strategic report.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report
for the Year Ended 31 March 2022

AUDITOR


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

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

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

The auditor, Ernst & Young LLP, Statutory Auditor, will be proposed for re-appointment at the forthcoming Annual General Meeting.

BY ORDER OF THE BOARD:

DocuSigned by:

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Sharmila Sylvester - Secretary

Date: 25-07-22 | 12:22 PM BST
.....

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Responsibilities Statement
for the Year Ended 31 March 2022

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland.

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, and prudent;
- state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations or have no realistic alternative but to do so.

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

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report and Directors' Report that complies with that law and those regulations.

Responsibility statement of the Directors in respect of the annual financial report

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company; and
- the Directors' report includes a fair review of the development and performance of the business and the position of the issuer, together with a description of the principal risks and uncertainties that they face.

Report of the Independent Auditor to the Members of Scotland Gas Networks Plc

Opinion

We have audited the financial statements of Scotland Gas Networks Plc for the year ended 31 March 2022 which comprise the Profit and Loss Account, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement, and the related notes 1 to 30 including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the Company's affairs as at 31 March 2022 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, 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

In auditing the financial statements, we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Due to group cash pooling arrangements, the company is dependent on a letter of support provided by its ultimate parent company, Scotia Gas Networks Limited. In assessing the company's ability to continue as a going concern we therefore obtained a copy of the letter of support and considered the Group's going concern assessment and its ability to provide that support.

The following are the procedures we performed over that group assessment which supports the Company assessment to the extent necessary to conclude on the company's ability to continue as a going concern:

- Understanding and walking through management's process for and controls related to assessing going concern including discussion with management to ensure all key factors were taken into account;
- Obtaining and performing mechanical integrity testing on management's going concern model, which is for the period to 31 July 2023, and which includes details of facilities available, covenant calculations, and the results of management's scenario planning;
- Comparing to the debt agreements both the maturity profile of the debt and the covenants that are required to be met within the going concern period;

Report of the Independent Auditor to the Members of
Scotland Gas Networks Plc

- Challenging key assumptions within the forecasts with the assistance of our specialist teams and with reference to the GD2 regulatory regime;
- Challenging management’s forecasts with reference to the audited results for the year ended 31 March 2022;
- Evaluated how these forecasts have been revised to reflect any impact of COVID-19, climate change and the war in Ukraine;
- Evaluating management's historical forecasting accuracy by comparing budgets to actual results;
- Assessing the consistency of the going concern assessment with information obtained from other areas of the audit;
- Performing reverse stress testing on the going concern model by understanding what reduction in EBITDA would be required before liquidity is exhausted and considering the likelihood of the events required to breach the covenants; and
- Evaluating the Group’s ability to undertake mitigating actions and considering whether those actions are within the Group’s control and the timing of when they could be implemented;

We reviewed the going concern disclosures in the company financial statements to ensure that they are in accordance with the reporting standards.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company’s ability to continue as a going concern for a period of 12 months (to 31 July 2023) from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the Directors with respect to going concern are described in the relevant sections of this report. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company’s ability to continue as a going concern.

Overview of our audit approach

Key audit matters	<ul style="list-style-type: none">• Valuation of the defined benefit obligation
Materiality	<ul style="list-style-type: none">• Overall materiality of £2.5m which represents 5% of the Company’s normalised and adjusted profit before tax. <p>The profit before tax is normalised and adjusted to exclude the accounting impacts of:</p> <ul style="list-style-type: none">- Incremental shrinkage costs due to exceptionally high wholesale gas prices; and- New inflation swap derivatives entered into during the year.

Report of the Independent Auditor to the Members of Scotland Gas Networks Plc

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the company. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the company and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed. All audit work was performed directly by the audit engagement team.

Climate change

There has been increasing interest from stakeholders as to how climate change will impact Scotland Gas Networks plc. The company has determined that the most significant future impacts from climate change on its operations will be from the impact of the shift towards a decarbonised energy system on the future of the gas network and managing changes as we move to a zero-carbon economy. These are explained on pages 5 to 10 in the principal risks and uncertainties section, which form part of the "Other information". Our procedures on these disclosures therefore consisted solely of considering whether they are materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appear to be materially misstated.

As explained in the key source of estimation uncertainty section of the financial statements on page 81, climate risks have been considered in the preparation of the financial statements where management consider it appropriate. The principal areas of consideration by management include the useful economic life of the networks and impairment of fixed assets.

Our audit effort in considering climate change was focused on evaluating management's assessment of the impact of climate risk and ensuring that the effects of material climate risks have been appropriately reflected by management in reaching their judgements in relation to the useful economic life of the networks and the impairment of fixed assets. We also challenged the Directors' considerations of climate change in their assessment of going concern and associated disclosures.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Report of the Independent Auditor to the Members of
Scotland Gas Networks Plc

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p>Valuation of the defined benefit obligation (£343m, PY comparative £375m)</p> <p><i>Refer to the Audit Committee Report (page 10); Accounting policies (page 77); and Note 23 of the Financial Statements (page 97)</i></p> <p>The Company operates a defined benefit pension scheme. Significant estimates and judgements are made in valuing the Company's pension obligation.</p> <p>Due to the quantum of the underlying balance, relatively small changes in key assumptions could have a significant effect on the calculation of the carrying value of the Company's pension obligation. Key assumptions include pension salary increases, the mortality rate, the discount rate and the RPI and CPI inflation rates.</p> <p>There is a risk that if one (or several assumptions in aggregate) are outside of an acceptable range, the defined benefit obligation would be incorrectly valued which would have a significant impact on the Company's financial position.</p>	<p>We performed the following audit procedures:</p> <ul style="list-style-type: none"> ➤ Performed walkthroughs of the pension process to verify our understanding and identify the key controls in place around the valuation assumptions; ➤ Assessed the independence, objectivity and competence of the external actuarial specialist; ➤ With support from our pension actuarial specialists, we independently benchmarked the key assumptions used in valuing the defined benefit obligation against an EY range derived from market data, to determine whether the assumptions were in an appropriate range. This included pension salary increases, the mortality rate, the discount rate, and the RPI and CPI inflation rates; ➤ Performed tests of detail for a sample of the participant data used by the external actuaries to confirm the completeness and accuracy of this data; ➤ Made inquiries of management and read the minutes of the meetings with Trustees, to confirm the completeness of accounting for any pension scheme transactions that have occurred in FY 2022; and ➤ Assessed the compliance of the related disclosures under FRS 102. 	<p>Based on the audit procedures performed, we consider the valuation of the Company's defined benefit obligation for the year ended 31 March 2022 to be appropriate.</p> <p>All assumptions used in valuing the obligation were within an acceptable EY range.</p> <p>We consider the disclosures to be appropriate and in accordance with FRS 102.</p>

Report of the Independent Auditor to the Members of
Scotland Gas Networks Plc

In the prior year, our auditor’s report included a key audit matter in relation to the valuation of goodwill. In the current year, there were no impairment indicators identified for the year ended 31 March 2022 and so no impairment assessment was required. The effect of this matter on the overall audit strategy, the allocation of resources in the audit and the direction of the engagement team was reduced significantly relative to the prior year, where an impairment assessment was required. Therefore the valuation of goodwill is not considered a key audit matter for the current year audit.

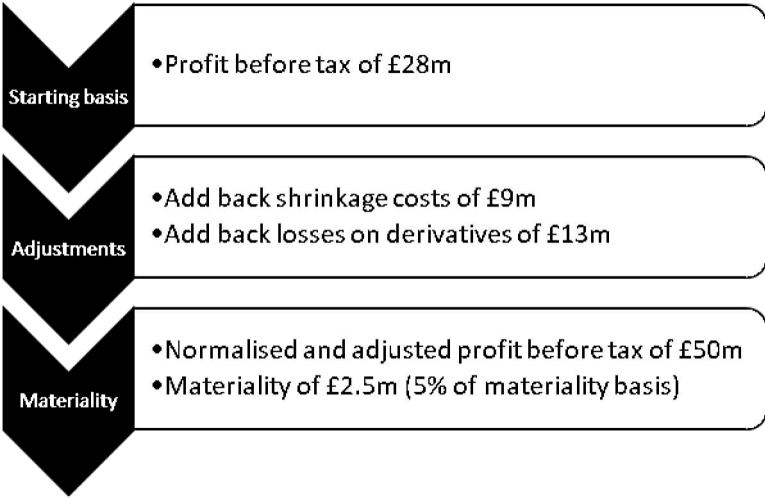
Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the company to be £2.5million (2021: £4.6 million), which is 5% (2021: 4%) of normalised and adjusted profit before tax to exclude the accounting impacts of shrinkage costs due to exceptionally high wholesale gas prices and the new inflation swap derivatives entered into during the year (2021: profit before tax). We believe that normalised and adjusted profit before tax provides us with the most relevant performance measure to the stakeholders of the entity and therefore have used this as the basis for determining materiality.



During the course of our audit, we reassessed initial materiality and changed our materiality basis from FY 2022 forecast profit before tax to FY 2022 normalised and adjusted profit before tax. We changed our basis to exclude the impact of transactions which are caused by fluctuating market conditions and infrequent material transactions.

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

Report of the Independent Auditor to the Members of Scotland Gas Networks Plc

On the basis of our risk assessments, together with our assessment of the company's overall control environment, our judgement was that performance materiality was 75% (2021: 50%) of our planning materiality, namely £1.9m (2021: £2.3m). We have set performance materiality at this percentage following a quantitative and qualitative assessment of prior year misstatements and our assessment of the Company's overall control environment. The performance materiality was set at 50% in the 2021 to take into account the additional complexities associated with a first-year audit for EY and the number and size of the misstatements identified by the predecessor auditor in the prior year.

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.1m (2021: £0.2m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The Directors are responsible for the other information contained with the annual report.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

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 course of 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 this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

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 directors' reports have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

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

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

Report of the Independent Auditor to the Members of Scotland Gas Networks Plc

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

Responsibilities of Directors

As explained more fully in the directors' responsibilities statement set out on page 55, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect irregularities, including fraud. The risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the company and management.

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the company and determined that the most significant are those that relate to the reporting framework (FRS 102 and the Companies Act 2006) and the local tax legislation. In addition, we concluded that there are certain significant laws and regulations which may have an effect on the determination of the amounts and disclosures in the financial statements being laws and regulations relating to health and safety, environmental protection and employee matters, notably pensions. In addition, the Company operates in a regulated market; it is subject to regulation from the national regulatory authorities in Great Britain.

Report of the Independent Auditor to the Members of Scotland Gas Networks Plc

- We understood how the Company is complying with those frameworks by making enquiries of management, internal audit and those responsible for legal and compliance procedures and the Company secretary. We corroborated our enquiries through our review of Board minutes, papers provided to the Audit Committee and correspondence received from regulatory bodies and noted that there was no contradictory evidence.
- We assessed the susceptibility of the company's financial statements to material misstatement, including how fraud might occur by meeting with management from various parts of the business to understand where it considered there was susceptibility to fraud. We considered the programmes and controls that the Company has established to address risks identified, or that otherwise prevent, deter and detect fraud; and how senior management monitors those programmes and controls. Where the risk was considered to be higher, we performed audit procedures to address each identified fraud risk. These procedures included using data analysis for testing journal entries that met our defined risk criteria based on our understanding of the business, testing a sample of batch journals which include a posting to revenue, and challenging the assumptions and judgements made by management in areas where judgement is required including those referred to in the key audit matters section above.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved understanding management's internal controls over compliance with laws and regulations; enquiry of legal counsel, management and internal audit; and reviewing internal audit reports and whistleblowing logs.

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

Other matters we are required to address

- Following the recommendation from the audit committee we were appointed by the Company on 30 June 2020 to audit the financial statements for the year ending 31 March 2021 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments is 2 years, covering the years ending 31 March 2021 to 31 March 2022.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the company and we remain independent of the company in conducting the audit.
- The audit opinion is consistent with the additional report to the audit committee.

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.

Ernst & Young LLP

Steven Dobson (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London

Date: 25 July 2022

Scotland Gas Networks Plc (Registered number: SC264065)Profit and Loss Account
for the Year Ended 31 March 2022

	Notes	2022 £m	2021 £m
TURNOVER	3	339	384
Net operating costs ¹		<u>(231)</u>	<u>(220)</u>
OPERATING PROFIT		108	164
Interest receivable and similar income	5	2	3
Interest payable and similar expenses	6	(69)	(47)
Fair value movements on derivatives	10	<u>(13)</u>	<u>(1)</u>
PROFIT BEFORE TAXATION	7	28	119
Tax on profit	8	<u>(79)</u>	<u>(23)</u>
(LOSS)/PROFIT FOR THE FINANCIAL YEAR		<u>(51)</u>	<u>96</u>

¹ Included within Net operating costs are exceptional items to the sum of £9m (2021: nil), see note 10 for more details.

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

The notes on pages 69 to 105 form part of these financial statements

Scotland Gas Networks Plc (Registered number: SC264065)Statement of Comprehensive Income
for the Year Ended 31 March 2022

	Notes	2022 £m	2021 £m
(LOSS)/PROFIT FOR THE YEAR		(51)	96
OTHER COMPREHENSIVE INCOME/(LOSS)			
Gain arising on cash flow hedges		15	13
Remeasurement on net pension asset		23	(28)
Income tax relating to components of other comprehensive (loss)/ income		<u>(6)</u>	<u>2</u>
OTHER COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR, NET OF INCOME TAX		<u>32</u>	<u>(13)</u>
TOTAL COMPREHENSIVE (LOSS)/INCOME FOR THE YEAR		<u>(19)</u>	<u>83</u>

The notes on pages 69 to 105 form part of these financial statements

Scotland Gas Networks Plc (Registered number: SC264065)Balance Sheet
31 March 2022

	Notes	2022 £m	2021 £m
FIXED ASSETS			
Intangible assets	11	106	111
Tangible assets	12	<u>2,159</u>	<u>2,119</u>
		<u>2,265</u>	<u>2,230</u>
CURRENT ASSETS			
Debtors	13	42	63
Cash at bank	14	<u>25</u>	<u>8</u>
		67	71
CREDITORS			
Amounts falling due within one year	15	<u>(379)</u>	<u>(86)</u>
NET CURRENT LIABILITIES		<u>(312)</u>	<u>(15)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		1,953	2,215
CREDITORS			
Amounts falling due after more than one year	16	(1,182)	(1,433)
PROVISIONS FOR LIABILITIES	19	(337)	(257)
DEFERRED INCOME	20	(176)	(171)
PENSION ASSET	23	<u>145</u>	<u>119</u>
NET ASSETS		<u>403</u>	<u>473</u>
CAPITAL AND RESERVES			
Called up share capital	21	49	49
Hedging reserve	22	(41)	(57)
Profit and loss account	22	<u>395</u>	<u>481</u>
SHAREHOLDERS' FUNDS		<u>403</u>	<u>473</u>

The financial statements were approved by the Board of Directors and authorised for issue on 25-07-22 | 12:17 PM BST and were signed on its behalf by:

DocuSigned by:

Nick Salmon

.....
 B044CB58CE1453
 Nicholas Robin Salmon (Chair) - Director

The notes on pages 69 to 105 form part of these financial statements

Scotland Gas Networks Plc (Registered number: SC264065)Statement of Changes in Equity
for the Year Ended 31 March 2022

	Called up share capital £m	Profit and loss account £m	Hedging reserve £m	Total equity £m
Balance at 1 April 2020	49	483	(67)	465
Profit for the year	-	96	-	96
Other comprehensive income	-	(23)	10	(13)
	<hr/>	<hr/>	<hr/>	<hr/>
Total comprehensive income	-	73	10	83
Dividends	-	(75)	-	(75)
	<hr/>	<hr/>	<hr/>	<hr/>
Balance at 31 March 2021	49	481	(57)	473
	<hr/>	<hr/>	<hr/>	<hr/>
Loss for the year	-	(51)	-	(51)
Other comprehensive income	-	16	16	32
	<hr/>	<hr/>	<hr/>	<hr/>
Total comprehensive loss	-	(35)	16	(19)
Dividends	-	(51)	-	(51)
	<hr/>	<hr/>	<hr/>	<hr/>
Balance at 31 March 2022	49	395	(41)	403
	<hr/>	<hr/>	<hr/>	<hr/>

The notes on pages 69 to 105 form part of these financial statements

Scotland Gas Networks Plc (Registered number: SC264065)Cash Flow Statement
for the Year Ended 31 March 2022

	Notes	2022 £m	2021 £m
Cash flows from operating activities			
Cash generated from operations	27	225	246
Interest paid	30	(43)	(39)
Tax paid		<u>(13)</u>	<u>(24)</u>
Net cash from operating activities		<u>169</u>	<u>183</u>
Cash flows from investing activities			
Purchase of intangible fixed assets		(3)	(1)
Purchase of tangible fixed assets		(98)	(99)
Customer contributions received		<u>9</u>	<u>7</u>
Net cash used in investing activities		<u>(92)</u>	<u>(93)</u>
Cash flows from financing activities			
Payments of mirror swaps	30	(8)	(3)
Payments of interest rate swaps		(4)	(4)
Receipts from inflation-linked swaps		3	-
Dividends paid		<u>(51)</u>	<u>(75)</u>
Net cash used in financing activities		<u>(60)</u>	<u>(82)</u>
		<u> </u>	<u> </u>
Increase in cash and cash equivalents		17	8
Cash and cash equivalents at beginning of year	28	8	-
		<u> </u>	<u> </u>
Cash and cash equivalents at end of year	28	<u>25</u>	<u>8</u>

The notes on pages 69 to 105 form part of these financial statements

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements
for the Year Ended 31 March 2022**1. ACCOUNTING POLICIES****General information and basis of preparation**

Scotland Gas Networks Plc is a private company limited by shares and is incorporated in Scotland under the Companies Act 2006. The address of the registered office is Axis House, 5 Lonehead Drive, Newbridge, Edinburgh, Scotland, EH28 8TG. The Company's principal activity is the development, administration, maintenance and operation of the Scotland gas distribution system and the supply of gas transportation services. The nature of the Company's operations is set out in the Strategic Report.

The financial statements have been prepared under the historical cost convention, modified to include certain items at fair value, and in accordance with Financial Reporting Standard 102 - 'The Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland' (FRS 102) issued by the Financial Reporting Council. There were no material departures from that standard.

The preparation of financial statements requires the use of certain critical accounting estimates. It also requires management to exercise judgement in applying the accounting policies.

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

The Company is a wholly owned subsidiary of SGN MidCo Limited. The ultimate parent undertaking is Scotia Gas Networks Limited, and the financial statements of the Company are included in the consolidated financial statements of Scotia Gas Networks Limited which can be obtained from St Lawrence House, Station Approach, Horley, Surrey, RH6 9HJ, United Kingdom.

The group has taken advantage of the exemption afforded by FRS 102.33.1A not to disclose transactions between wholly owned members of the group.

The company is a qualifying entity as defined by FRS 102 and has taken advantage of the following exemptions available to qualifying entities which are relevant to its financial statements:

- the requirement to disclose information about key management personnel compensation;
- the disclosure requirements of Section 11 paragraphs 11.42, 11.44, 11.45, 11.47, 11.48(a)(iii), 11.48(a)(iv), 11.48(b) and 11.48(c) in respect of financial instruments of the parent (as equivalent disclosures are included in respect of the consolidated financial statements).

The following principal accounting policies have been applied:

Going concern

The Company's accounts have been prepared on a going concern basis.

The Directors have forecast cash flows of the company for the next twelve months to 31 July 2023 (the going concern period) and have obtained a support letter from Scotia Gas Networks Limited confirming that it can and will support the Company in meeting its liabilities throughout the going concern period.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**1. ACCOUNTING POLICIES - continued**

In assessing the ability of the company to rely on this support the Directors have considered the going concern assessment undertaken at the Scotia Gas Networks Limited group level, the conclusion of which is that even under severe but plausible downside scenarios there is headroom in relation to both liquidity and covenants.

Consequently, the Directors believe that the Company will be able to meet its liabilities as they fall due and will have adequate resources to continue in operational existence for twelve months (to 31 July 2023) from the date of approval of this report. Accordingly, the Directors continue to adopt the going concern basis in preparing the financial statements.

Turnover

Turnover is stated net of value added tax and is attributable to the continuing activity of transportation of natural gas and the provision of related services. Turnover is recognised to the extent that there is a right to consideration and is recorded at the value of the consideration due.

Intangible assets - goodwill

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

Intangible assets - software

Software assets are included at cost, net of amortisation and any provision for impairment. Amortisation is provided on a straight-line basis over their estimated useful economic life of 3 to 10 years. The Company's intangible assets have a remaining useful economic life ranging between 1 - 6 years.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**1. ACCOUNTING POLICIES - continued****Tangible fixed assets**

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. The cost is the purchase cost of the asset, together with any directly attributable costs incurred in bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. In accordance with Ofgem guidance for gas transportation licensees and as allowable under FRS 102, costs include an element of capitalised overheads which are, as far as reasonably practicable, allocated in accordance with the activities which lead to the generation of the assets. These costs are directly attributable to the associated assets.

Depreciation is recognised on all tangible fixed assets, other than freehold land, at rates calculated to depreciate the cost or valuation, less estimated residual value, of each asset on a straight-line basis over its expected useful life, as follows:

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

Replacement expenditure is capitalised and the useful life is based on the range within mains and services above.

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

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

Fixed Asset Investments

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

Investments are reviewed for impairment if events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairments are calculated such that the carrying value of the fixed asset investment is the lower of its cost or recoverable amount. Recoverable amount is the higher of its net realisable value and its value in use.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**1. ACCOUNTING POLICIES - continued****Customer contributions**

Customer contributions for connections to the network and for replacement expenditure diversions are treated as capital grants. They are accounted for as deferred income (creditors due after more than one year) and released to profit and loss on a straight-line basis over the estimated life of the related asset. The corresponding asset is capitalised within fixed assets and is depreciated over its useful economic life. Customer contributions which have been received by the end of the financial year, for which the corresponding asset has not yet been delivered are treated as creditors due within one year.

Financial instruments

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

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

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

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

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

i. Effective interest method

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

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

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**1. ACCOUNTING POLICIES - continued****ii. Financial Assets**

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

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

iii. Impairment of financial assets

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

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

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

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

iv. Derecognition of financial assets

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

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements – continued
for the Year Ended 31 March 2022**1. ACCOUNTING POLICIES - continued****v. Trade debtors**

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

vi. Cash

Cash comprises cash on hand and demand deposits, which are those deposits, which are repayable on demand and available within 24 hours (one day) without penalty. The Company receives monies in the form of grants and contributions towards innovation projects. The use of this cash is restricted by the specific terms and conditions of each project.

vii. Financial liabilities

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

viii. Financial liabilities at FVTPL

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

A financial liability is classified as held for trading if:

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

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

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

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

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**1. ACCOUNTING POLICIES - continued****ix. Other financial liabilities**

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

x. De-recognition of financial liabilities

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

xi. Derivative financial instruments and hedge accounting

The Company uses interest rate swaps and cross currency swaps to hedge interest rate and foreign currency risk arising on debt instruments.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each reporting date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

The best evidence of fair value is a quoted price for an identical asset in an active market. When quoted prices are unavailable, the price of a recent transaction for an identical asset provides evidence of fair value as long as there has not been a significant change in economic circumstances or a significant lapse of time since the transaction took place. If the market is not active and recent transactions of an identical asset on their own are not a good estimate of fair value, the fair value is estimated by using a valuation technique.

On inception of the hedge relationship the Company documents the relationships between the hedged item and the hedging instrument along with the risk management objectives and its strategy for undertaking various transactions. Furthermore, at inception of the hedge and on an ongoing basis the Company documents whether the hedging relationship is highly effective, which do not qualify for hedge accounting treatment.

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

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

Hedge accounting is discontinued when the hedge instrument expires or is terminated. Financial assets and financial liabilities are offset where they are settled net as a matter of practice and there is legal right to offset.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**1. ACCOUNTING POLICIES – continued****Taxation**

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

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

Timing differences are differences between the Company's taxable profits and its results as stated in the financial statements that arises from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

Unrelieved tax losses and other deferred tax assets are recognised only to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

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

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

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

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

The Company uses inflation-linked swaps to hedge its inflation-linked regulated asset base and turnover, which do not qualify for hedge accounting treatment however the fair value movements on these financial instruments are disregarded for tax purposes.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**1. ACCOUNTING POLICIES - continued****Employee benefits****i. Defined benefit pension scheme**

The Company participates in a group wide defined benefit pension plan administered by the ultimate parent undertaking, Scotia Gas Networks Limited. The net defined benefit cost of the plan is charged and accounted for based on the proportionate number of members relating to the Company. The contributions payable by the Company is determined on the same basis as the charging policy above.

For defined benefit schemes the amounts charged to operating profit are the costs arising from employee services rendered during the year and the cost of plan introductions, benefit changes, settlements and curtailments. They are included as part of staff costs. The net interest cost on the net defined benefit liability is charged to profit or loss and included within finance costs. Remeasurement comprising actuarial gains and losses and the return on scheme assets (excluding amounts included in net interest on the net defined benefit liability) are recognised immediately in other comprehensive income.

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

When the calculation results in a net asset to the Company, the recognised asset is limited to the present value of any future refunds from the plan or reductions in future contributions to the plan and restricted by any relevant asset ceiling. Any deduction made by the tax authorities in the event of a refund of a surplus would be regarded by the Company as an income tax.

ii. Defined contribution pension scheme

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

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**1. ACCOUNTING POLICIES - continued****Impairment of non-financial assets**

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

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

Goodwill impairment

The recoverable amount of goodwill is the higher of the value in use or the fair value less cost to dispose. This is derived from measurement of the present value of the future cash flows of the business. Any impairment loss is allocated first to the goodwill, and then to other assets on a pro-rata basis.

Other non-financial assets

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

Borrowing costs capitalised

Borrowing costs which are directly attributable to the construction of qualifying tangible fixed assets are capitalised as part of the cost of those assets. Qualifying tangible fixed assets are considered to be those of significant size or complexity, which typically are under construction for in excess of one year and/or where project costs exceed a pre-determined threshold. The commencement of capitalisation begins when both finance costs and expenditures for the asset are being incurred and activities that are necessary to get the asset ready for use are in progress. Capitalisation ceases when substantially all the activities that are necessary to get the asset ready for use are complete. Borrowing costs are not capitalised in respect of construction projects which do not meet the defined thresholds or relate to replacement expenditure.

Operating leases

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

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**1. ACCOUNTING POLICIES - continued****Provisions**

A provision is recognised in the balance sheet when the Company has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are discounted where the impact of discounting the expected future cash flows is material. No provision is required for the repair of gas pipes as these are replaced on an agreed basis with the regulator.

Interest receivable and Interest payable

Interest payable and similar expenses include interest payable recognised in profit or loss using the effective interest method, unwinding of the discount on provisions, and net foreign exchange losses that are recognised in the profit and loss account (see foreign currency accounting policy).

Other interest receivable and similar income include interest receivable on funds invested and net foreign exchange gains.

Interest income and interest payable are recognised in profit or loss as they accrue, using the effective interest method. Dividend income is recognised in the profit and loss account on the date the entity's right to receive payments is established. Foreign currency gains and losses are reported on a net basis.

Dividends

Equity dividends are recognised when they become legally payable. Interim equity dividends are recognised when paid. Final equity dividends are recognised when approved by the shareholders at an annual general meeting.

Exceptional items

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 considered to be one-off in nature. 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 impairments of non-current assets and inventories, significant changes in provisions, gains or losses on disposals of businesses or investments, or other one-off material events.

Fair value movements on derivatives

Fair value movements 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 is not effective.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**2. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY**

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

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

Critical accounting judgements

- a** Cost classification - costs are allocated amongst six work activities: operating expenditure, innovation, replacement expenditure, capital expenditure, non-formula and non-regulated. Judgement is involved in allocating time spent to the different activities. The management of each of the cost centres, with guidance and support from the relevant finance business partners, allocate the percentage of time each individual in the respective teams spent on the six work activities during the year. This is then fed into the Cost Allocation Model which is used to determine the split of attributable overheads between capital expenditure and operating expenditure.
- b** Impairment of fixed assets - as set out in note 1 above, management has exercised judgement during the company balance sheet review when identifying impairment indicators affecting the fixed assets of the Company.
- c** Exceptional items - The categorisation of certain items as exceptional 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 considered to be one-off in nature. See note 10.
- d** Supplier of last resort – Management have given consideration to the Supplier of Last Resort (SoLR) mechanism under the Company's regulatory transportation licenses. The Company accounts for SoLR payments as levies, and as such will only be obliged to pay the costs when reciprocating incremental revenue will be generated from 1 April 2022. There is no material impact of the SOLR mechanism to the financial statements in the current or prior year.

Key source of estimation uncertainty

- a** Useful lives of assets - The Group depreciates its assets over their useful economic lives. The estimation of the useful lives of assets is based on historic performance as well as expectations about future use and therefore requires estimates and assumptions to be applied by management. The useful economic lives of assets can vary depending on a variety of factors, including technological innovation, climate change and climate related impacts, product life cycles, maintenance programmes as well as the economic life of the gas industry. The depreciation policy is set out in note 1.
- b** Retirement benefit schemes - the assumptions used in accounting for the defined benefit pension scheme are based on estimates and are subject to uncertainties. These assumptions are set out in the note 'employee benefits' and include: the discount rate on scheme liabilities, mortality rates, pension increases, salary increases and inflation. The Company takes advice from independent actuaries on the appropriateness of these assumptions

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**2. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY - continued**

- c Valuation of financial instruments - where financial instruments are recognised at fair value there are uncertainties in forward yield curves used in discounted cash flow calculations.
- d Environmental provision - in assessing the degree of contamination at the various sites, estimation is required where elements of the contamination are underground. In these cases, it is difficult to assess with any certainty the extent of the contamination. The discount rate is also a source of estimation. See note on provisions.
- e Climate change - In assessing the impact of climate change on the Company, management have considered two key areas being useful economic life and impairment of fixed assets. Management believes the role of hydrogen in the UK's energy transition will support the UEL of the networks. Therefore, the Company assesses that there is currently limited exposure to climate related risks.

3. TURNOVER

Analysis of turnover by class of business:

	2022	2021
	£m	£m
Transportation of natural gas and the provision of related services	339	384

All turnover arose in the United Kingdom.

4. EMPLOYEES AND DIRECTORS

The Company had 236 full-time equivalent employees as at 31 March 2022 (2021: 275). The average monthly number of full-time equivalent employees during the year was 250 (2021: 279).

	2022	2021
Field based staff	117	136
Office and other administrative staff	119	139
	<u>236</u>	<u>275</u>

The Independent Directors received remuneration totalling £99,324 (2021: £62,953) for their services to the Company during the year. No retirement benefits are accruing in the year or in the prior year to any Directors under money purchase or defined benefit schemes, in respect of their services to the Company. There are 7 directors who did not receive any remuneration in respect of services to the company during the current or preceding financial year. These directors are employed by the SGN Group's shareholders and do not specifically receive any remuneration in respect of the company and the time spent working as a board member on SGN was deemed immaterial.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**4. EMPLOYEES AND DIRECTORS - continued**

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

	2022 £m	2021 £m
Wages and salaries	11	13
Social security costs	1	1
Pension costs (Note 23)	<u>12</u>	<u>12</u>
	<u>24</u>	<u>26</u>

The company utilises the services of employees contracted to a fellow group company. The cost of these services recharged to the Company in the year were £37m (2021: £37m) which are included within Net operating costs in the Profit and Loss account, but excluded from the table above.

5. INTEREST RECEIVABLE AND SIMILAR INCOME

	2022 £m	2021 £m
Net defined benefit pension income	<u>2</u>	<u>3</u>

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**6. INTEREST PAYABLE AND SIMILAR EXPENSES**

	2022 £m	2021 £m
Interest payable on fixed rate instruments	28	32
Interest payable on floating rate instruments	1	-
Interest payable on inflation-linked instruments	35	13
Other interest payable	5	2
Unwinding of discount	-	-
	<u>69</u>	<u>47</u>

Included within interest payable on inflation-linked instruments is £24m of accretion on RPI-linked debt instruments (31 March 2021: £4m).

In March 2022, the Company agreed to settle outstanding fees due in relation to certain guarantees provided by Ambac Assurance UK Limited that were previously in place over certain outstanding public bond instruments. The cash settlement amount of £4m is included within the interest paid line of the cash flow statement.

7. PROFIT BEFORE TAXATION

The profit is stated after charging/(crediting):

	2022 £m	2021 £m
Depreciation - owned assets	58	54
Loss on disposal of fixed assets	-	1
Goodwill amortisation	3	2
Computer software amortisation	5	5
Amortisation of customer contributions	(4)	(4)
Rental under operating leases	<u>1</u>	<u>2</u>

Auditor's remuneration for the Company comprises:

- Audit of these financial statements £147,300 (2021: £124,500)
- Audit-related assurance services £49,600 (2021: £40,000)
- Other assurance services £14,900 (2021: £12,000)

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**8. TAXATION****Analysis of the tax charge**

The tax charge on the profit for the year was as follows:

	2022 £m	2021 £m
Current tax:		
UK corporation tax	8	26
Prior year adjustment	<u>(2)</u>	<u>(1)</u>
Total current tax	<u>6</u>	<u>25</u>
Deferred tax:		
Origination and reversal of timing differences	(2)	(2)
Prior year adjustment	(1)	-
Effect of change in tax rate	<u>76</u>	<u>-</u>
Total deferred tax	<u>73</u>	<u>(2)</u>
Tax on profit	<u>79</u>	<u>23</u>

UK corporation tax has been charged at 19% (2021 - 19%).

Reconciliation of total tax charge included in profit and loss

The tax assessed for the year is higher than (2021: same as) the standard rate of corporation tax in the UK. The difference is explained below:

	2022 £m	2021 £m
Profit before tax	<u>28</u>	<u>119</u>
Profit multiplied by the standard rate of corporation tax in the UK of 19% (2021 - 19%)	5	23
Effects of:		
Adjustments to tax charge in respect of previous periods	(3)	(1)
Non-deductible goodwill	1	1
Effect of change in tax rates	<u>76</u>	<u>-</u>
Total tax charge	<u>79</u>	<u>23</u>

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**8. TAXATION - continued****Tax effects relating to effects of other comprehensive income**

	2022		
	Gross £m	Tax £m	Net £m
Gain arising on cash flow hedges	15	1	16
Remeasurement on net pension asset	<u>23</u>	<u>(7)</u>	<u>16</u>
	<u>38</u>	<u>(6)</u>	<u>32</u>

	2021		
	Gross £m	Tax £m	Net £m
Gain/(Loss) arising on cash flow hedges	13	(3)	10
Remeasurement on net pension asset	<u>(28)</u>	<u>5</u>	<u>(23)</u>
	<u>(15)</u>	<u>2</u>	<u>(13)</u>

The standard rate of tax applied to reported profit on ordinary activities is 19% (2021: 19%). Finance Bill 2021 increases the main rate of corporation tax from 19% to 25% from 1 April 2023. As these changes have been substantively enacted at the balance sheet date deferred tax has been calculated based on the rate that is expected to apply when the deferred tax is reversed, resulting in an increase to the company's deferred tax liability at 31 March 2022 by £76m (2021: £nil). There is no expiry date on timing differences, unused tax losses or tax credits.

Movements in deferred tax take into account the effects of changes in the fair value liability of the Company's inflation-linked swap portfolio. Increases or reductions in the fair value liability of the Company's inflation linked swap portfolio represent an increase or reduction in the present value of the future cash flows that will be payable/receivable on those inflation-linked swaps in future years. Changes to the fair value of the liability are not tax deductible under UK tax regulations as tax deductions are only available as and when the interest payments/receipts are actually accrued. The increase in the fair value of the inflation-linked swap portfolio will therefore create an accounting cost which is not subject to taxation until the cash flow is accrued and therefore creates a timing difference. The fair value of the inflation-linked swap portfolio can fluctuate significantly and there will be a consequential impact on the deferred tax provision.

9. DIVIDENDS

Interim dividends paid for the year ended 31 March 2022 amount to £51m (102.65p per share) (2021: £75m (151.84p per share)). No further dividends were proposed.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**10. EXCEPTIONAL ITEMS AND FAIR VALUE MOVEMENTS ON DERIVATIVES**

	2022 £m	2021 £m
Exceptional items included within Net operating costs:		
Cost impact of increase in gas wholesale prices*	9	-
Fair value movements on derivatives:		
Net losses on derivative financial instruments**	<u>13</u>	<u>1</u>
Total included within profit before tax	22	1
Included within taxation:		
Tax on cost impact of increase in gas wholesale prices	(2)	-
Tax on fair value movements	<u>(3)</u>	<u>-</u>
Total included within taxation	<u>(5)</u>	<u>-</u>
Total exceptional items after tax	<u>17</u>	<u>-</u>

Analysis of total exceptional items and fair value movements after tax

Total exceptional items after tax	7	-
Total fair value movements after tax	10	-

*As a result of the sharp increase in gas wholesale prices, the cost of shrinkage gas for the year ended 31 March 2022 was £9m, which exceeded the forecast value included in the tariff charges by £7m. Additionally, the high gas prices resulted in the insolvency of shipper CNG, resulting in a bad debt recognised in 2022 of £2m. Management consider the impact of the rise in wholesale gas prices to be material in value, one off in nature and as such consider it appropriate to disclose as an exceptional item. These costs will be recovered in the next financial year under the regulatory mechanism and so the corresponding revenue will be disclosed as exceptional in the subsequent period. There was a cash outflow as a result of exceptional costs of £7m (2021: £nil).

**Net losses on derivative financial instruments comprise gains and losses arising on derivative financial instruments reported in the Statement of Profit and Loss. These exclude gains and losses for which hedge accounting has been effective, which has been recognised directly in other comprehensive income. There was nil impact (2021: £nil) to the cash flow as a result of the fair value movements on financial derivatives. Included within net losses on derivative financial instruments £7m of accretion on CPI-linked swaps (31 March 2021: £nil).

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**11. INTANGIBLE FIXED ASSETS**

	Goodwill £m	Computer software £m	Totals £m
COST			
At 1 April 2021	143	71	214
Additions	<u>-</u>	<u>3</u>	<u>3</u>
At 31 March 2022	<u>143</u>	<u>74</u>	<u>217</u>
AMORTISATION			
At 1 April 2021	45	58	103
Amortisation for year	<u>3</u>	<u>5</u>	<u>8</u>
At 31 March 2022	<u>48</u>	<u>63</u>	<u>111</u>
NET BOOK VALUE			
At 31 March 2022	<u>95</u>	<u>11</u>	<u>106</u>
At 31 March 2021	<u>98</u>	<u>13</u>	<u>111</u>

There is no security held against the intangible fixed assets of the Company.

The amortisation charge is recognised in Net operating costs in the profit and loss account.

The goodwill, which arose on the acquisitions of the business by the Company is being amortised on a straight-line basis over 50 years, with 33 years remaining. 50 years is the expected life of the network and is consistent with the long-term outlook of the Regulator.

A review for impairment of goodwill is carried out when there are indicators of impairment. As at 31 March 2022, following management's assessment of internal and external impairment indicators, no such indicators were noted. As such no impairment charge has been recorded for the current year (2021: £nil).

No impairment loss has been recorded in the current year or prior years.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**12. TANGIBLE FIXED ASSETS**

	Freehold property	Plant and machinery	Motor vehicles and office equipment	Totals
	£m	£m	£m	£m
COST				
At 1 April 2021	41	2,609	44	2,694
Additions	2	92	5	99
Disposals	-	(2)	-	(2)
At 31 March 2022	<u>43</u>	<u>2,699</u>	<u>49</u>	<u>2,791</u>
DEPRECIATION				
At 1 April 2021	12	536	27	575
Charge for year	1	52	5	58
Eliminated on disposal	-	(1)	-	(1)
At 31 March 2022	<u>13</u>	<u>587</u>	<u>32</u>	<u>632</u>
NET BOOK VALUE				
At 31 March 2022	<u>30</u>	<u>2,112</u>	<u>17</u>	<u>2,159</u>
At 31 March 2021	<u>29</u>	<u>2,073</u>	<u>17</u>	<u>2,119</u>

13. DEBTORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2022	2021
	£m	£m
Trade debtors	27	33
Amounts owed by group undertakings	-	22
Corporation tax	12	4
Prepayments and accrued income	<u>3</u>	<u>4</u>
	<u>42</u>	<u>63</u>

For details of Amounts owed by group undertakings see Note 15.

14. CASH AT BANK

	2022	2021
	£m	£m
Cash at bank	<u>25</u>	<u>8</u>

Cash and cash equivalents contain £25m (2021: £8m) of cash which is contractually restricted to be used only on designated innovation projects.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**15. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR**

	2022	2021
	£m	£m
Inflation-linked debt (see note 17)	266	-
Trade creditors	29	9
Amounts owed to group undertakings	15	-
Social security and other taxes	6	6
Other creditors	3	3
Accrued interest	10	10
Deferred income	18	16
Accruals	32	42
	<u>379</u>	<u>86</u>

Amounts owed to group undertakings includes:

- intercompany trade balances due to the Group of £23m (2021: £24m).

This is partially offset by:

- an intercompany loan due from Southern Gas Networks plc of £9m (2021: £45m). The loan is repayable on demand and bears interest at the Bank of England Base Rate. The intercompany loan balance due from Southern Gas Networks plc is significantly lower as at 31 March 2022 than at the previous year end. This is driven by the net cashflow movements, as the intercompany loan is the result of the daily automated cash pooling.

Included in inflation-linked debt falling due within one year are loans and public bonds consisting of:

	2022	2021
	£m	£m
£165m 2.127% RPI-linked note due 2022	<u>266</u>	<u>-</u>

In March 2022, the Company signed a £100m CPI-linked term loan facility to part refinance the Company's £165m RPI-linked bond maturing in October 2022. The loan facility is split into two tranches, with a £50m 7-year tranche, maturing in September 2029, carrying a CPI-linked interest rate of negative -0.8818%; and a £50m 10-year tranche, maturing in September 2032, carrying a CPI-linked interest rate of -0.4465%. On both tranches principal and accretion is payable at the respective maturity dates and both have a 6-month delayed draw feature, meaning they were undrawn as at 31 March 2022.

16. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	2022	2021
	£m	£m
Borrowings (see note 17)	1,112	1,354
Derivative financial liabilities - hedging swaps	57	71
Derivative financial liabilities - mirror swaps	-	8
Derivative financial liabilities - inflation-linked swaps	13	-
	<u>1,182</u>	<u>1,433</u>

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**16. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR - continued**

Included in amounts falling due after more than one year, are public bonds, private placement notes and loans consisting of

	2022 £m	2021 £m
Fixed rate debt:		
£35m 2.407% fixed rate loan due 2025	35	35
£250m 3.25% fixed rate note due 2027*	247	247
£75m 2.74% fixed rate note due 2030	75	75
£75m 1.980% fixed rate note due 2032	75	75
£50m 2.04% fixed rate note due 2033	50	50
£75m 2.87% fixed rate note due 2033	75	75
£225m 4.875% fixed rate note due 2034*	225	225
	<hr/>	<hr/>
	782	782
	<hr/>	<hr/>
Inflation-linked debt:		
£165m 2.127% RPI-linked note due 2022*	-	255
£125m 2.317% RPI-linked note due 2039*	185	172
	<hr/>	<hr/>
	185	427
	<hr/>	<hr/>
Floating rate debt:		
£30m floating rate loan due 2026	30	30
£35m floating rate loan due 2026	35	35
£80m floating rate note due 2043*	80	80
	<hr/>	<hr/>
	145	145
	<hr/>	<hr/>
Total debt	<hr/> <hr/> 1,112	<hr/> <hr/> 1,354

* Listed on the London Stock Exchange.

The above debt instruments are unsecured and are stated after the deduction of unamortised issue costs of £3m (2021: £4m). These costs together with the interest expense are allocated to the profit and loss account over the term of the debt. Interest is calculated using the effective interest rate method.

Certain interest costs in respect of RPI-linked bonds are not payable until the principal amount of the bond is repaid and are included within the carrying value of the debt stated above. Certain interest costs in respect of CPI-linked swaps are not payable until the maturity of the swap. The amount in relation to the RPI-linked bonds included in the carrying value of the debt at 31 March 2022 is £162m (2021: £137m). The amount in relation to the CPI-linked swaps included in the carrying value of the debt at 31 March 2022 is £7m (2021: £nil). The amounts debited to the profit and loss account in relation to RPI-linked and CPI-linked accretion during the year amounted to £24 (2021: £4m) and £7m (2021: £nil) respectively.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**16. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR - continued**

The total revolving credit facility is £235m (2021: £120m) and expires in March 2025. The facility was undrawn at the year end.

Interest Rate Benchmark Reform

During the 12 months to 31 March 2022 the Company transitioned its debt and other financial instruments carrying a floating rate of interest with a GBP London Interbank Offer Rate ("LIBOR") benchmark to a new benchmark, the Sterling Overnight Index Average ("SONIA"). In order to maintain an equal economic relationship before and after transition, and in line with best industry practice, the terms of these financial instruments were also amended to include a credit adjustment spread. There was no material impact on the financial statements as a result of the change from LIBOR to SONIA, and the transition was accounted for prospectively.

17. BORROWINGS

An analysis of the maturity of public bonds, private placements and loans is given below:

	2022 £m	2021 £m
Between one and five years	347	290
After five years	<u>765</u>	<u>1,064</u>
	1,112	1,354
On demand or within one year	<u>266</u>	<u>-</u>
	<u><u>1,378</u></u>	<u><u>1,354</u></u>

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**18. FINANCIAL INSTRUMENTS**

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

The Company is a wholly owned subsidiary of SGN MidCo Limited. The financial statements of the Company are included in the consolidated financial statements of the ultimate parent undertaking, Scotia Gas Networks Limited, therefore under FRS 102 the Company is exempt from certain disclosures required under sections 11 and 12.

Categories of financial instrument

The categories of financial liabilities held by the company are as follows:

	2022	2021
	£m	£m
Financial liabilities held at amortised cost		
Trade creditors	29	9
Accrued interest	10	10
Accruals	32	42
Borrowings	<u>1,379</u>	<u>1,354</u>
	1,450	1,415
Financial liabilities held at fair value		
Derivative financial instruments in designated hedging relationships	57	71
Financial derivatives - mirror swaps	-	8
Financial derivatives - inflation-linked swaps	<u>13</u>	<u>-</u>
	<u>70</u>	<u>79</u>
Total financial liabilities	<u><u>1,520</u></u>	<u><u>1,494</u></u>

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**18. FINANCIAL INSTRUMENTS - continued**

The Company conducted a review of counterparty credit risk and its own credit risk and concluded that an adjustment was required to reflect the net credit risk in arriving at the fair value of financial instruments stated in the balance sheet. The net credit risk adjustment reduced liabilities by £5m (2021: £nil). £5m (2021: £nil) was credited to the profit and loss account. £nil (2021: £nil) was charged to other comprehensive income. A discounted cash flow method was used in the above. At 31 March 2022, the Company was holding collateral with a fair value of £nil (2021: £nil).

Inflation-linked swaps

During the 12 months to 31 March 2022 Scotland Gas Networks plc transacted £130m of CPI-linked swaps that economically convert some or all of the notional principal of the following existing fixed rate debt instruments into CPI-linked debt instruments:

- £75m fixed rate notes maturing in 2030; and
- £55m of the £75m fixed rate notes maturing in 2033.

Mirror swaps

In 2005 the Company entered into interest rate swap contracts to fix the Company's interest cost relating to (floating rate) bridging loans which were in place at the time. In October 2005, permanent long-term capital markets debt was issued to replace floating rate bridging loans. At that point these swaps became obsolete and consequently matching swaps were transacted (under which the Group received fixed rate interest) to close out the position. The crystallised loss was recognised in the profit and loss and a discounted balance equal to the market value of the matched swaps was established within creditors.

In March 2022 both sides of the Company's mirror swaps were terminated with the mark to market value cash settled for a total consideration of £6m. The debit has been taken to the financial instruments liability in the balance sheet and a difference of £0.3m between the carrying mark to market value of the swaps compared and the settlement value has been written off within the interest receivable and similar income line in the profit and loss account. This will result in the elimination of any liability for the mirror swaps on the Company's balance sheet. The £6m cash settlement has been recognised in the " payments of mirror swaps " line of the cash flow statement, within cash flows from financing activities.

At 31 March 2022 the mirror swap loss was £nil (2021: £8m).

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**19. PROVISIONS FOR LIABILITIES**

	2022 £m	2021 £m
Deferred tax	<u>321</u>	<u>242</u>
Other provisions		
Other provisions	9	7
Environmental provisions	<u>7</u>	<u>8</u>
	<u>16</u>	<u>15</u>
Aggregate amounts	<u>337</u>	<u>257</u>

	Deferred tax £m	Environmental and Other provisions £m
Balance at 1 April 2021	242	15
Net movement in deferred tax	79	-
Reassessment during the year	<u>-</u>	<u>1</u>
Balance at 31 March 2022	<u>321</u>	<u>16</u>

The discount unwind on environmental provisions, included in interest payable and similar expenses in the profit and loss account, was £129,113 (2021: £100,621).

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**19. PROVISIONS FOR LIABILITIES - continued****Environmental**

The environmental provision represents the Directors' best estimate of environmental restoration costs, where the Company has a legal obligation to restore sites at the balance sheet date. The provision has been discounted and is stated at the present value of the expenditure expected to be required to settle the obligation. The provision is expected to be utilised over the next four years in line with anticipated regulatory outputs requirements for land remediation.

Other provisions

Other provisions include asbestos related liabilities. The provision has been discounted and is stated at the present value of the estimated expenditure to settle the obligation. The provision is expected to be utilised over the next 30 years.

Deferred tax

Deferred tax is provided as follows:

	2022	2021
	£m	£m
Accelerated capital allowances	300	232
Deferred tax on cash flow hedges	(14)	(13)
Deferred tax on inflation swaps	(1)	-
Deferred tax on retirement benefit obligations	<u>36</u>	<u>23</u>
Deferred tax	<u>321</u>	<u>242</u>

The movement in provision for deferred tax is as follows:

	2022	2021
	£m	£m
Opening balance	242	246
Charged/(credited) to profit and loss account	73	(2)
Charged/ (credited) to other comprehensive income	<u>6</u>	<u>(2)</u>
Deferred tax	<u>321</u>	<u>242</u>

The Company is not expecting a reversal of deferred tax in the next financial year. There is no expiry date on timing differences, unused tax losses or tax credits.

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

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**19. PROVISIONS FOR LIABILITIES - continued**

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

The Company has no unrecognised deferred tax assets or liabilities.

20. DEFERRED INCOME

	2022	2021
	£m	£m
Deferred income	<u>176</u>	<u>171</u>

Customer contributions

The Company has received customer contributions relating to plant and machinery. In accordance with the Company's accounting policy the assets are capitalised within fixed assets and the contributions are recognised as deferred income in the balance sheet. The connections contributions are from customers being connected to the network and replacement contributions are related to the diversion of gas mains.

The deferred income is released to the profit and loss account over the estimated lives of the related assets.

The amount deferred under this policy was as follows:

	Connections	Replacement	Total
	2022	2022	2022
	£m	£m	£m
Customer contributions brought forward	99	72	171
Customer contributions deferred in the year	8	1	9
Amortisation in year	<u>(3)</u>	<u>(1)</u>	<u>(4)</u>
	<u>104</u>	<u>72</u>	<u>176</u>

Customer contributions exclude Deferred income presented as part of Creditors: Amounts falling due within one year, as those amounts relate to unfinished projects, where the associated asset is not yet completed.

21. CALLED UP SHARE CAPITAL

Allotted, issued and fully paid:

Number:	Class:	Nominal value:	2022	2021
			£	£
49,392,787	Ordinary	£1	<u>49,392,787</u>	<u>49,392,787</u>

There is a single class of ordinary shares. There are no restrictions on the distribution of the dividends and the repayment of capital.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**22. RESERVES**

	Profit and loss account £m	Hedging reserve £m	Totals £m
At 1 April 2021	481	(57)	424
Loss for the year	(51)	-	(51)
Dividends	(51)	-	(51)
Movement in cash flow hedges	-	16	16
Remeasurement of net defined benefit asset	<u>16</u>	<u>-</u>	<u>16</u>
At 31 March 2022	<u>395</u>	<u>(41)</u>	<u>354</u>

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

23. EMPLOYEE BENEFIT OBLIGATIONS**Defined contribution schemes**

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

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

	2022 £m	2021 £m
Amount charged in respect of defined contribution schemes	<u>5</u>	<u>5</u>

At the balance sheet date, there were outstanding contributions of £nil (2021: £nil).

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**23. EMPLOYEE BENEFIT OBLIGATIONS - continued****Defined benefit schemes**

The Company is a wholly owned subsidiary of SGN MidCo Limited. The ultimate parent undertaking is Scotia Gas Networks which operates the Scotia Gas Networks Pension Scheme, a defined benefit scheme for a significant number of its employees of its subsidiaries who prior to 1 December 2005 were previously members of the Lattice Company Scheme and had joined prior to 31 March 2002. Under the Scheme, the employees are entitled to retirement benefits based on final salary on attainment of retirement age (or earlier withdrawal or death). The Scheme is open to future accrual of benefits and closed to new members. Employees joining the Lattice Company Scheme after 31 March 2002 were entitled to join a defined contribution scheme. Under the Group cost allocation plan, the Company accounts for its agreed share of the total net defined benefit cost, based on the proportionate members relating to the Company.

The most recent triennial valuation of the Scheme was carried out at 31 March 2018. The Company has employed an independent actuary to approximately update this valuation allowing for differences between the actuarial assumptions used by the Scheme for funding purposes and those adopted by the Company to measure the Scheme's liabilities on the financial statements, as well as adjusting for benefit accrual and benefits paid by the Scheme. The present value of the defined benefit obligation, the related current service cost and past service cost were measured using the projected unit credit method. In accordance with FRS 102, a limited actuarial review has been carried out by H&C LLP at 31 March 2022 using the projected unit method.

	As at 31 March 20 22	As at 31 March 20 21
Key assumptions used:		
Retail price inflation	3.8% p.a.	3.5% p.a.
Consumer price inflation	3.4% p.a.	3.1% p.a.
Rate of increase of pensions payment	3.8% p.a.	3.5% p.a.
Rate of increase of salaries	3.6% p.a.	3.3% p.a.
Discount rate	<u>2.8% p.a.</u>	<u>2.0% p.a.</u>

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

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

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**23. EMPLOYEE BENEFIT OBLIGATIONS - continued**

As at 31 March	2022		2021		2020	
	Male	Female	Male	Female	Male	Female
Members currently aged 65	22.8	24.4	22.7	24.3	22.7	24.2
Members currently aged 45	24.5	27.0	24.4	26.9	24.3	26.4

The approximate effects of movements in the main assumptions on the defined benefit obligation are shown in the table below:

	Sensitivity	Approximate change in DBO £000
Discount rate	- 0.1% p.a. + 0.1% p.a.	7,040 (6,880)
Price inflation (RPI measure)*	- 0.1% p.a. + 0.1% p.a.	(6,640) 6,800
Life expectancy	- 1 year + 1 year	(14,040) 14,640

*These movements have been calculated assuming that changes in the inflation assumption have a knock-on effect on the pension increase and salary growth assumptions (i.e. the "real" increase rates are maintained). Note that the sensitivities do not allow for the movement in the insured pensioner asset, therefore the net balance sheet movement is smaller.

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

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**23. EMPLOYEE BENEFIT OBLIGATIONS - continued**

As at 31 March	2022			2021		
	Quoted Fair Value £m	Unquoted Fair Value £m	Total Fair Value £m	Unquoted		Total Fair Value £m
				Quoted Fair Value £m	Fair Value £m	
Equities	51	-	51	54	-	54
Government bonds [1]	214	-	214	185	-	185
Corporate bonds	76	44	120	83	56	139
Property	-	-	-	-	-	-
Cash	-	4	4	8	-	8
Insurance contracts	-	99	99	-	108	108
Total market value of assets	341	147	488	330	164	494
Actuarial value of liabilities			(343)			(375)
Net pension asset			145			119

[1] Including LDI repurchase agreement liabilities.

The fair value of scheme assets at 31 March 2022 are based on the bid price where available. The fair value of property is based on the mid-price and the value of the single unit price funds is based on the single unit price.

To reduce the risk of volatility in the Scheme's funding level, a liability driven investment (LDI) strategy forms part of the assets employed within the investment strategy of the Scheme. The LDI strategy provides c95% interest rate protection and c95% inflation protection as at 31 March 2022 with respect to the pension scheme liabilities of c.£1.2bn (valued using a UK government bond yield curve). The Scheme assets which provide this interest rate and inflation protection are managed by BlackRock and Goldman Sachs and include a variety of instruments e.g. UK government bonds (gilts), interest rate swaps, inflation swaps, gilt repos and corporate bonds. The Scheme has implemented a pensioner buy in which also contributes to the total interest rate and protection ratios referred to above. Movements in the present value of defined benefit obligations were as follows:

	2022 £m	2021 £m
At 1 April	(375)	(313)
Current service cost	(7)	(7)
Interest cost	(7)	(7)
Actuarial gains/(losses)	29	(64)
Benefits paid	17	16
At 31 March	(343)	(375)

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**23. EMPLOYEE BENEFIT OBLIGATIONS - continued**

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

	2022 £m	2021 £m
At 1 April	494	455
Interest income	10	10
Contributions from the Company	8	9
Remeasurement of scheme assets	(6)	36
Benefits paid	(17)	(16)
Administration costs	(1)	-
	<u>(1)</u>	<u>-</u>
As at 31 March	<u>488</u>	<u>494</u>

The actual loss on scheme assets was £6m (2021: £40m gain).

Employer contributions for the period ending 31 March 2022 were 37.3% (2021: 37.3%) of monthly salary roll, before allowing for any salary sacrifice contributions. Deficit contributions are also payable at the rate of £5m p.a. from 1 April 2020 to 31 March 2022 (2021: £5m p.a).

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

	2022 £m	2021 £m
Current service cost	(7)	(7)
Administration costs	(1)	-
	<u>(1)</u>	<u>-</u>
Total charged to operating profit:	(8)	(7)
Expected return on scheme assets	10	10
Interest charge on scheme liabilities	(7)	(7)
	<u>(7)</u>	<u>(7)</u>
Net interest credit	3	3
	<u>3</u>	<u>3</u>
Total charge to the profit and loss account	<u>(5)</u>	<u>(4)</u>
	<u>(5)</u>	<u>(4)</u>
	2022 £m	2021 £m
Actuarial (losses)/gains on scheme assets	(6)	36
Actuarial gains/(losses) on scheme obligations	29	(64)
	<u>23</u>	<u>(28)</u>
Gains recognised in other comprehensive income	<u>23</u>	<u>(28)</u>

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**24. FINANCIAL COMMITMENTS**

Capital projects contracted for by the Company but not provided in the financial information amounted to £6m at 31 March 2022 (2021: £4m).

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

	Other		Land and Buildings	
	2022	2021	2022	2021
	£m	£m	£m	£m
- less than one year	1	1	1	1
- between two to five years	1	1	2	2
- after five years		-	2	2

25. RELATED PARTY DISCLOSURES

The immediate parent undertaking is SGN MidCo Limited.

The ultimate parent undertaking is Scotia Gas Networks Limited, a Company registered in England and Wales.

The largest group in which the results of the Company are consolidated is that headed by Scotia Gas Networks Limited, St Lawrence House, Station Approach, Horley, RH6 9HJ, United Kingdom. The smallest group in which they are consolidated is that headed by SGN MidCo Limited, St Lawrence House, Station Approach, Horley RH6 9HJ, United Kingdom. Copies of Scotia Gas Networks Limited consolidated financial statements can be obtained from the Company Secretary, St Lawrence House, Station Approach, Horley, Surrey RH6 9HJ, United Kingdom.

During the year, Scotia Gas Networks Limited underwent an ownership change. It is owned by a consortium consisting of Apple Newco Limited (37.5%) which is indirectly wholly owned by Ontario Teachers' Pension Plan Board, UK Gas Distribution 2 Limited (37.5%) which is indirectly wholly owned by Brookfield Super-Core Infrastructure Partners and Speyside Bidco Limited (25.0%), which is wholly owned by Global Infrastructure Partners (GIP).

Previously, Scotia Gas Networks Limited was owned by a consortium consisting of SSE plc (33.3%), OTPPB Investments (UK) Limited (25.0%), which is owned by 2465817 Ontario Limited, Borealis Infrastructure Europe (UK) Limited (25.0%), which is indirectly wholly owned by OMERS Administration Corporation, and Blue Spyder B 2016 Limited (16.7%), which is owned by Abu Dhabi Investment Authority.

It is the opinion of the Directors that the parent Company, Scotia Gas Networks Limited, has no single controlling party as that Company is controlled jointly by the consortium.

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

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**25. RELATED PARTY DISCLOSURES - continued****Transactions with Key Management Personnel**

The Company's ultimate parent undertaking, Scotia Gas Networks includes the Company in its consolidated financial statements. In these financial statements, the Company is considered to be a qualifying entity and has applied the exemptions available under FRS 102 in respect of the Key Management Personnel compensation disclosures.

Transactions with shareholders

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

	2022 £m	2021 £m
Other amounts owed to shareholders:		
SSE plc	-	5

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

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

	2022 £m	2021 £m
Sales of goods and services	4	5
Purchase of goods and services	(11)	(8)

Sales of goods and services to SSE primarily represent gas transportation services. At 31 March 2022 an amount of £nil (2021: £nil) was owed by SSE in relation to these services.

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

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**26. SUBSEQUENT EVENTS**

There are no subsequent events to report.

27. RECONCILIATION OF PROFIT BEFORE TAXATION TO CASH GENERATED FROM OPERATIONS

	2022	2021
	£m	£m
Profit before taxation	28	119
Depreciation charges	58	54
Loss on disposal of fixed assets	-	1
Amortisation of deferred income	(4)	(4)
Amortisation charges	8	7
Increase in provisions	2	2
Interest payable and similar expenses	69	47
Fair value movement on derivatives	13	1
Interest receivable and similar income	<u>(2)</u>	<u>(3)</u>
	172	224
Decrease in trade and other debtors	7	17
Increase in trade and other creditors	<u>46</u>	<u>5</u>
Cash generated from operations	<u><u>225</u></u>	<u><u>246</u></u>

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2022**28. CASH AND CASH EQUIVALENTS**

The amounts disclosed on the Cash Flow Statement in respect of cash and cash equivalents are in respect of these Balance Sheet amounts:

Year ended 31 March 2022

	31.3.22 £m	1.4.21 £m
Cash and cash equivalents	<u>25</u>	<u>8</u>

Year ended 31 March 2021

	31.3.21 £m	1.4.20 £m
Cash and cash equivalents	<u>8</u>	<u>-</u>
	<u>8</u>	<u>-</u>

29. ANALYSIS OF CHANGES IN NET DEBT

	At 1.4.21 £m	Cash flow £m	Other non-cash movement £m	At 31.3.22 £m
Net cash				
Cash at bank	<u>8</u>	<u>17</u>	<u>-</u>	<u>25</u>
	<u>8</u>	<u>17</u>	<u>-</u>	<u>25</u>
Debt				
Debts falling due within 1 year (note 15)	-	-	(266)	(266)
Debts falling due after 1 year (note 16)	<u>(1,354)</u>	<u>-</u>	<u>242</u>	<u>(1,112)</u>
	(1,354)	-	(24)	(1,378)
Total	<u>(1,346)</u>	<u>17</u>	<u>(24)</u>	<u>(1,353)</u>

Other non-cash movements in borrowings relate to movements in the fair value of financial instruments and the amortisation of borrowing fees.

30. OTHER NOTES TO THE CASH FLOW STATEMENT

Included within the amount disclosed on the Cash Flow Statement under Interest paid for 2022 is £4m in relation to the settlement of fees due to a prior guarantor of certain public bonds held by the Company (see note 6 for more details).

Included within the amount disclosed on the Cash Flow Statement under Payments of mirror swaps for 2022 is £6m in relation to the termination of the Company's mirror swaps (see note 18 for more details).