

REGISTERED NUMBER: SC264065 (Scotland)

Scotland Gas Networks Plc

Strategic Report, Directors' Report and

Audited Financial Statements for the Year Ended 31 March 2023

Scotland Gas Networks Plc (Registered number: SC264065)

Contents of the Financial Statements
for the Year Ended 31 March 2023

	Page
Company Information	1
Strategic Report	2
Directors' Report	29
Directors' Responsibilities Statement	58
Report of the Independent Auditor	59
Profit and Loss Account	67
Statement of Comprehensive Income	68
Balance Sheet	69
Statement of Changes in Equity	70
Cash Flow Statement	71
Notes to the Financial Statements	72

Scotland Gas Networks Plc

Company Information
for the Year Ended 31 March 2023

DIRECTORS:

Charlotte Brunning
Paul Jeffery
Charles Thomazi (Alternate)
Laura Sandys
Nicholas Robin Salmon (Chair)
Michael Botha
Rebecca Lumlock
Felipe Ortiz
Paul Trimmer
Martin Catchpole
Christian Fingerle
Michael Oswald Smart
Antoine Kerrenneur
Jeffrey Rosenthal

SECRETARIES:

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Sharmila Sylvester

REGISTERED OFFICE:

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Newbridge
Edinburgh
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REGISTERED NUMBER:

SC264065 (Scotland)

AUDITOR:

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London
SE1 2AF

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2023

The Directors present their strategic report for the year ended 31 March 2023.

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 2023 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. Scotia Gas Networks Limited is owned by 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 owned by Brookfield Super-Core Infrastructure Partners, and Speyside Bidco Limited (25.0%) which is wholly-owned by funds managed by Global Infrastructure Partners (GIP).

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.

2. Making a positive impact

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

Scotland Gas Networks Plc (Registered number: SC264065)

Strategic Report
for the Year Ended 31 March 2023

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 network are also taken into account. A cost of capital for the required investment in the networks is also determined.

The Company is also subject to safety legislation which is enforced by the Health and Safety Executive ("HSE") in the UK. The 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 2023 was the second year of the RIIO-GD2 price control, which set the key elements of revenue, outputs and allowed returns until 31 March 2026.

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.

Scotland Gas Networks Plc (Registered number: SC264065)

Strategic Report
for the Year Ended 31 March 2023

- **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, which is 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 2023**PRINCIPAL RISKS AND UNCERTAINTIES**

The aim of our enterprise risk framework is to enable a consistent approach to how we identify, assess, manage, and monitor risks and uncertainties to the successful delivery of our strategic and operational objectives.

Our current 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.

To ensure that the Company focuses on the right risks as we work to build a thriving and enduring business, our principal risks are to be fully reassessed (and our associated risk appetite considered) in the first half of 2023/24 by the Executive Committee and Board.

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.	<ul style="list-style-type: none"> - Active in influencing government and industry stakeholders to lobby for hydrogen rollout. - Creation of the Strategic Hydrogen Executive with other GDNs. - Delivering the SGN evidentiary framework and developing plans for heat decarbonisation rollout. - Utilising innovation funding and working with others to test and deliver evidence for potential decarbonisation pathways. - Developing plans to develop hydrogen storage and production investment opportunities.
2. Cyber and IT resilience: Failure to implement appropriate security risk management and crisis management could result in cyber-attacks from nation states, hacktivists, criminals, and/or insiders.	<ul style="list-style-type: none"> - Cyber security investment programme in place and funding requests made for next stage of the programme.
Loss of critical IT services due to the design of core services and/or ineffective Business Continuity Management plans.	<ul style="list-style-type: none"> - Increased in-house security team and enhanced managed security service.

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2023

Description and Impact of Risk (cont.)	Mitigation (cont.)
Loss of IT services could result in interruption or disruption to our core business operations.	<ul style="list-style-type: none"> - Compliance with the Network and Information Systems (NIS) Regulation. - Ongoing work to maintain and improve business continuity and disaster recovery procedures. - Hardware and network resilience/segmentation in place. - Maintenance plan and activities in place to manage the risk of IT failure. - Raising staff security awareness through regular training and awareness campaigns. - Participation in audits and exchanges on learnings and best practices.
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.	<ul style="list-style-type: none"> - Contributing to development of UK and Scottish Government policy. - Continuing to build capability to explain our role and how we contribute to delivery of government policy ambitions. - Targeted engagement with local authorities to develop decarbonisation plans. - Assessment of Scottish independence risk/opportunity to the Company.
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.	<ul style="list-style-type: none"> - Training and development including talent management programmes, which are being reviewed to ensure future fit. - Recruitment of the required number of operational, front-line employees has been made a company-wide priority.

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2023

<u>Description and Impact of Risk (cont.)</u>	<u>Mitigation (cont.)</u>
	<ul style="list-style-type: none"> - Outsourcing of some training to approved suppliers. - Responding to regulatory, supplier and technology developments which may impact on Company strategy. - Three-year pay deal protecting employees against inflationary pressures, plus attract and retain people. - Retraining and recruiting in synchrony with the hydrogen transition.
<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>	<ul style="list-style-type: none"> - Health and Safety is our number one priority, and we continue to focus on the Company's safety culture. - Continued focus on safety across all assets and operations, including any changes related to a transition to hydrogen. - Track a range of safety metrics very closely and have programmes in place to drive improvements. - Review lessons learnt from major incidents in order to prevent such things from recurring. - Compliance is supported by independent inspections and an audit programme. - Run wellbeing programmes and campaigns for our people. - Emphasis on leading indicators.
<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 within the group.</p>	<ul style="list-style-type: none"> - The Company has a treasury policy which aims to maintain: <ul style="list-style-type: none"> • 12 to 18 months' committed sources of liquidity (cash and committed facilities); • A smooth debt maturity profile to minimise annual refinancing requirements and spread refinancing risk; • Access to diversified sources of funding; • A proportion of direct or synthetic inflation-linked debt liabilities. - Regular internal monitoring and reporting of key credit metrics and financial covenants to the Board.

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2023

<u>Description and Impact of Risk (cont.)</u>	<u>Mitigation (cont.)</u>
	<ul style="list-style-type: none"> - Annual results presentations intended for debt investors. - A flexible dividend distribution policy linked to maintaining credit metrics.
<p>7. Environment and climate adaptations: 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>	<ul style="list-style-type: none"> - Delivering the Environmental Action Plan and Environmental Sustainability Strategy. - Engaging with the supply chain to support their journey of decarbonisation and environmental improvement. - Regular interaction with stakeholders and customers including collaboration with SGN Environment Advisory Panel. - Engaging with peers and other companies in the energy and infrastructure sectors to enable a best practice approach. - Maintaining our ISO14001:2015 Environmental Management System certification. - Understanding and assessing climate risk to occupied sites and our network. - Pilot projects to demonstrate the safe, efficient and effective transport, storage and use of hydrogen.
<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 our business, its relationships, processes, products and services.</p>	<ul style="list-style-type: none"> - Programmes to strengthen our compliance framework, supported by risk-based training programmes. - Code of Conduct and compliance policies covering controls. - Speak Up (Whistleblowing) Policy. - Company contracts include compliance clauses. - Training and communications to guide and support our people to meet legal and regulatory requirements.

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2023

<u>Description and Impact of Risk (cont.)</u>	<u>Mitigation (cont.)</u>
	<ul style="list-style-type: none"> - Ongoing assessments to help manage compliance risks associated with business change/developments. - 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>	<ul style="list-style-type: none"> - Developing and harnessing new suppliers to encourage competition, innovation and resilience. - Supplier performance management and compliance across key areas. - New Logistics team in place to prepare for migration of Logistics service from existing Managed Services Agreement provider. - Ongoing support and management of contracts and supply chains. Planning to deal with short and long-term shocks. - Online sourcing and contract management system. - Issued new Sustainable Procurement Code.
<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>	<ul style="list-style-type: none"> - Clear asset investment strategy out to March 2026. - Core business processes help ensure that gas supply to the customer is maintained. - Long-term horizon scanning is in place to capture network asset changes. - Robust annual audit programme and site inspections to ensure compliance with our policies and procedures. - Closely track a range of asset and safety related metrics and have programmes in place to drive improvements. - Test resiliency through several activities such as emergency exercises and risk assessment tools. - A physical security upgrade programme designed to meet government agencies' guidelines.

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2023**Description and Impact of Risk (cont.)****Mitigation (cont.)**

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.

- Learning from incidents within the Company and externally.

- Customer Experience GD2 project, utilising customer insight to ensure we are meeting customer expectations.

- Focused training plans to embed processes and upskill our people to deliver the best.

- Vulnerable Customer Strategy to harness new partners and encourage innovation for services and communications.

- Ongoing support and management of external relationships to maximise collaboration and co-operation.

- Contributing, together with all stakeholders, to the development of a fair and affordable transition.

12. Licence conditions: Failure to comply with our licence conditions and obligations.

- Governance and compliance frameworks to deal with issues and developments arising from price controls.

- Experienced regulation, finance and legal teams.

- Engaging with all levels of Ofgem and government.

- Delivery of regulatory outputs is measured and monitored on a regular basis. Action plan put in place to ensure Emergency Response KPIs that were missed in financial year 22/23 are achieved in the coming year.

- Annual Compliance Report.

- Improved data analytics and predictive models including to inform resourcing requirements.

Scotland Gas Networks Plc (Registered number: SC264065)

Strategic Report
for the Year Ended 31 March 2023

Leadership are responsible for identifying, responding to, monitoring and assuring key risks. They are supported by the Risk function.

Our Risk and Resilience Committee includes representation from all parts of the business with a mixture of the Executive team and Senior Leadership. The Risk and Resilience Committee supports the Executive team by overseeing the operational risk registers and making recommendations. It meets quarterly to review the Company's current and future risk profile and resilience capabilities.

The Executive owns and oversees the enterprise risk management framework. 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. The Executive receives formal updates following the Risk and Resilience Committee and are supported by the Risk function to ensure ongoing risk management.

The Board has overall responsibility for making sure that we manage risk within acceptable limits. Our most significant risks are reported to the Board on a bi-monthly basis by our CEO and semi-annually the Board carries out a review of the full principal risk register. The Board is supported by the Audit Committee, who oversees internal controls within the Company. The Board also considers new or emerging risks and recommends ways to tackle them.

Enhancing our risk framework

In 2022/23 we partnered with a specialist provider to conduct a risk maturity assessment and have commenced a programme of work supported by them to reach the next level of maturity in service of achieving our future strategic and operational objectives. Our 2023/24 Annual Report will provide further detail on this.

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.

Scotland Gas Networks Plc (Registered number: SC264065)

Strategic Report
for the Year Ended 31 March 2023

SECTION 172(1) STATEMENT

Section 172(1) of the Companies Act 2006 requires a Director of a Company to act in the way they consider, in good faith, would most likely promote the success of the Company for the benefit of its members as a whole.

In doing so Section 172(1) requires a Director to have regard (among other matters) to:

- a . The likely consequences of any decisions in the long term.
- b . The interests of the Company's employees.
- c . The need to foster the Company's business relationships with suppliers, customers and others.
- d . The impact of the Company's operations on the community and environment.
- e . The desirability of the Company to maintain a reputation for high standards of business conduct.
- f . The need to act fairly between members of the Company.

In discharging their Section 172 duty, the Directors of the Company have regard to the factors set out above. We acknowledge that every decision the Board makes will not necessarily result in a positive outcome for all of our stakeholders.

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.

On the following page, we have set out an example of how the Directors have had regard to the matters set out in Section 172(1) (a) to (f) when discharging their Section 172 duty and the effect of those on decisions taken by them.

Further details on how the SGN Board operates and how it reaches decisions, including some of the matters discussed and debated during the year, are detailed in this section and on pages 34 to 42.

Scotland Gas Networks Plc (Registered number: SC264065)

Strategic Report
for the Year Ended 31 March 2023

Board decision: Supporting the development of SGN's future of Energy strategy and continued investment

Section 172 factors

Directors' consideration of Section 172 Factors

Long-term impact

The UK Government plans for decarbonisation of heat in order to achieve net zero by 2050, and 2045 in Scotland. This presents both an opportunity for the Company to be influential in shaping the future of energy and a challenge. The Company must be able to articulate and execute a robust strategy based on a comprehensive analysis and evaluation of the strategic options in context of likely future states. Establishing a strategic approach and continuing to invest in the future of energy/decarbonisation pathway to achieve net zero will help transition the business to provide a clean energy experience which is key to the Company's vision.

Impact on employees

The Company is committed to providing job security for our colleagues during the energy transition and beyond. In order to do so, the Company continues to work toward proving the viability of future of energy associated projects. To further ensure the success of the strategic approach and keeping our people in mind, the Company provides regular updates on the progress of projects and developments to ensure our people are kept informed and actively encouraged to provide any feedback. More information on how we engage with our people can be found on page 16.

Nurturing business relationships

The Company continues to collaborate and work alongside industry peers, the government, local authorities and Ofgem to support and participate in the development of the UK's pathway to decarbonisation which includes developing pioneering clean energy projects to help shape the UK's future.

Impact on community and environment

The UK's biggest net zero challenge is decarbonising our homes and buildings. It's the second biggest emitting sector with around 30% of our national emissions coming from around 25 million homes which are connected to gas networks across the UK. The decarbonisation of homes will impact our communities, customers and environment. Customer research helps the Company to understand what matters most to our end-users. Our policy and political work linked to our strategy will amplify our hydrogen demonstration projects and establish as the clear and cost-effective pathway to decarbonise heat at lower cost and disruption to end-users, at pace and scale.

Scotland Gas Networks Plc (Registered number: SC264065)

Strategic Report
for the Year Ended 31 March 2023

Board decision: Supporting the development of SGN's future of Energy strategy and continued investment (continued)

Section 172 factors (cont.)

Enhanced corporate reputation

Acting fairly between members

Directors' consideration of Section 172 Factors (cont.)

SGN continues to create the political space to ensure hydrogen is an option in the UK's energy transition and alongside this, that the Company's reputation is strengthened as a world-leading network in the transition from natural gas to hydrogen.

SGN has three supportive shareholders with each having nominated representation on the Board. The Board seeks to always act fairly between shareholders and treat them equally, including ensuring that adequate procedures are in place to address any conflicts of interests that could arise and ensuring equal access to information. With this in consideration, the Board acknowledges the support from its members and also support the ongoing development of the future of energy strategy to support our customers, the community and the Government's plans in reaching net zero and longevity of the business.

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2023**Board decision: Approval of continuing investment in our Cyber Security Programme****Section 172 factors****Directors' consideration of Section 172 Factors**

Long-term impact

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

By not investing in our cyber resilience, we would put our Company at risk of attacks from national states, hackers, criminals and/or insiders. Investment is required to ensure our continued cyber resilience against ever-growing threats.

Impact on employees

To maximise the effectiveness of our cyber security programme, we continue to raise employee awareness of cyber risks, and how to protect employees and our Company against cyber threats through training and awareness campaigns.

Nurturing business relationships

The Company continues to work with industry peers and government agencies to ensure our cyber security programme is robust and complies with relevant directives. The Company also receives learnings and best practice from its shareholders' portfolio companies. Following Russia's attack on Ukraine, the National Cyber Security Centre called on UK organisations (including SGN) to bolster their online defences. Ofgem has also provided a Cyber resilience briefing to the Company and its Board of Directors. The continued investment allows the Company to deliver on stakeholder expectations.

Impact on community and environment

An extreme cyber event could prevent us from distributing gas to our 1.8 million customers. Investment is essential to ensure our cyber defence continues to adapt and improve to the ever-evolving cyber threat landscape, as well as to minimise the risk and impact of cyber events on our core business.

Enhanced corporate reputation

We must invest in our cyber resilience through the cyber security programme to give us the best chance of mitigating the threat of attacks. An attack on our systems that impacts our ability to keep our customers safe and warm could have a catastrophic impact on our corporate reputation.

Acting fairly between members

SGN's shareholders and the Executive management team fully support the decision to continue investing in cyber security.

Scotland Gas Networks Plc (Registered number: SC264065)

Strategic Report for the Year Ended 31 March 2023

ENGAGING WITH STAKEHOLDERS

Engaging with our stakeholders is fundamental not just to our day-to-day activity, but also 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.

We encourage genuine two-way engagement with our key stakeholder groups. Stakeholder engagement takes place at both the operational day-to-day level within the business and at Board level, as part of an extensive engagement programme with our six key stakeholders:

- Customers
- Our People
- UK and Scottish governments and Regulators
- Communities and Environment
- Suppliers, Contractors and Partners
- Shareholder and Debt Investors

The Board takes insight from each level of engagement into account in its decision-making process. Following the lifting of Covid-19 restrictions, we conducted a mixture of face-to-face and virtual engagement to ensure that this remained inclusive and allowed for a two-way dialogue with our stakeholders.

The panels that follow set out some of the most notable ways in which we engaged with each of our six key stakeholder groups and, where relevant, the impact of that engagement on our strategy.

OUR PEOPLE

We employ 199 highly skilled and dedicated people across Scotland.

Why we engage

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

How we engage

- SGNapp, Energy FM, Yammer and DigitalHub
- Town hall sessions, Team Talk, employee networks, CEO coffee sessions and safety briefings
- Trade union and pension trustee engagement
- Diversity and inclusion networks
- Annual employee engagement survey
- In person confidential engagement sessions between the Board and our people

Stakeholder issues raised

- Cost of living crisis and pay
- Availability of resources, vans and equipment
- Post-pandemic desire for more flexible ways of working

Outcomes of engagement on key decisions

- Conducting a benchmarking exercise on pay
- Additional investment in resourcing and procurement of essential tools and equipment, including operational vehicles
- Supporting the implementation of the flexible working model developed following the workplace review

Scotland Gas Networks Plc (Registered number: SC264065)

Strategic Report for the Year Ended 31 March 2023

- Working with relevant unions and stakeholders to ensure the Company operates as fair employer
- Continued reporting on performance of the stakeholder issues raised at every meeting of the Board and bi-monthly CEO Board update calls
- Continued focus and discussions on safety of our people, company culture, diversity and inclusion, employee training programs, retention and recruitment, fleet given the issues raised

Key Board decisions

- Communication and cascading of key insights and actions to the Company's leadership team
- Approval of strategic architecture to deliver excellence today and assist in the transformation of SGN for a decarbonised future
- Support to invest further in the resourcing of direct labour
- Approval of the recommendations presented following the benchmarking exercise regarding pay for our people
- Approval of SGN's Code of Conduct which additionally includes expectations regarding culture, safety, diversity and inclusion for our people

CUSTOMERS

We keep gas flowing safely and reliably to 1.8 million homes and businesses, all day, every day.

Why we engage

Understanding our existing and future customer needs and behaviours helps us to achieve our vision of giving our customers the best clean energy experience.

How we engage

- Customer forums, focus groups and research panels
- Customer satisfaction surveys
- Our Customer and Stakeholder Engagement Group (CSEG)
- Our Vulnerability Steering Group
- Our website and social media channels

Stakeholder issues raised

- Changes in customers' expectations relating to service delivery and customer experience in the post-pandemic era
- Regulatory changes pertaining to customer satisfaction performance, guaranteed standards of service and support for customers in vulnerable circumstances
- Customer experience is impacted by behaviours of our people, quality of communication, information quality, and efficiency of processes and timescales for delivery

Outcomes of engagement on key decisions

- We have further invested in customer experience and data interrogation to understand the drivers of customer contacts and complaints, which has led to a steady reduction in inbound contacts
- Utilisation of digital channels including live chat and two-way SMS has enabled more efficient resolution, and improvements in service have included PayPal integration, speech analytics and application portal improvements
- The Board continues to regularly meet and obtain feedback from the Customer Engagement Group

Scotland Gas Networks Plc (Registered number: SC264065)

Strategic Report
for the Year Ended 31 March 2023

Key Board decisions

- Investment and implementation of the customer strategy to continually improve and strive for number one in customer satisfaction across GDNs by further enhancing our responsiveness, implementing proactive measures and improved data and insight to predict where issues may occur in the future
- Approval of the annual health & safety targets for the financial year which impacts customers and other stakeholders

COMMUNITIES AND THE ENVIRONMENT

We've established multiple strategic and long-term partnerships with third-sector organisations representing hard-to-reach and vulnerable groups within our communities, as well as environmental bodies.

Why we engage

Engaging with communities enables us to build our shared net-zero future by accelerating decarbonised energy solutions and minimising our environmental impact, while also ensuring the support we provide to vulnerable groups is delivering tangible benefits to those most in need of help to stay safe and warm at home.

How we engage

- Community liaison groups
- Drop-in community events and virtual workshops
- School assemblies and hydrogen education workshops
- Our Environmental Advisory Group
- Our Vulnerability Steering Group

Stakeholder issues raised

- Carbon impact associated with operating our business
- The role of green gases in the transition to net zero carbon emissions
- ESG performance and Task Force on Climate related Financial Disclosures ('TCFD') reporting

Outcomes of engagement on key decisions

- Focused discussion on shrinkage performance, and innovative activities to drive down emissions
- Continued performance reporting on SGN's operations and Repex delivery programme at Board meetings
- Conducted a dedicated Energy Futures strategy session covering hydrogen and the journey to net zero
- Development of the Environmental Action Plan and Communities investment strategy

Key Board decisions

- Investment in third-party partnerships with strong board support
- Approved further investment into SGN's hydrogen (H100) project
- Agreement to SGN's community support plan for winter 2022

Scotland Gas Networks Plc (Registered number: SC264065)

Strategic Report
for the Year Ended 31 March 2023

SUPPLIERS, CONTRACTORS AND PARTNERS

We're supported by a significant number of suppliers and contractors to keep our customers safe and warm, while our joint venture partners enable us to develop new technologies and alternative heat solutions.

Why we engage

Our suppliers, contractors and partners play a critical role in enabling us to deliver a safe and efficient service and collectively reduce our environmental impact.

How we engage

- Operational contractor roadshows
- Supplier checkpoint review meetings
- Supplier Relationship Management (SRM) programme
- Sustainability Supply Chain School

Stakeholder issues raised

- The conclusion of existing contracts including fleet and IT services
- Contractors' and suppliers' ability to provide ESG-related information
- Resourcing crisis - recruitment and retention

Outcomes of engagement on key decisions

- The development and launch of the Company's Sustainable Procurement Code has introduced a new requirement for Suppliers we contract with to adhere to the code, including greater provision of ESG-related data and information
- Introduction of a new fleet framework contract approved for provision of operational vehicles
- Development of the Company's Safety Improvement Plan which includes active engagement with the supply chain in setting clear health and safety expectations

Key Board decisions

- Approval of Modern Slavery Statement
- Approval of new fleet service providers
- Approval of a new supplier for the delivery of Service Desk, End User Computer and IT Service Management processes
- Support for suppliers delivering greater sustainability through procurement and training

Scotland Gas Networks Plc (Registered number: SC264065)

Strategic Report for the Year Ended 31 March 2023

GOVERNMENT AND REGULATORS

We work constructively and collaboratively with both UK and Scottish governments as well as regulatory bodies such as Ofgem and the HSE.

Why we engage

Understanding what drives government and regulatory policy decisions helps us to ensure we deliver on our regulatory outputs to keep our customers safe and warm.

How we engage

- Senior government and regulatory engagement is led by the CEO on behalf of the Board. The type of engagement includes: bilateral meetings; attendance at round tables; government/industry working groups.
- The CEO also has oversight of formal government and regulatory consultations that has material impact on our operations and customers.

Stakeholder issues raised

- Price controls
- Supplier of last resort
- Decarbonisation of gas
- Cost of living crisis impact on fuel poor and vulnerable customers
- Cyber security
- Operational resilience and security of supply

Outcomes of engagement on key decisions

- Continued investment in our Cyber Security Programme to put in place additional precautionary measures to mitigate increasing threat levels
- Cyber Security Resilience briefing by Ofgem received by the Board
- Provision of wider support for the Company for increased political engagement on decarbonisation
- Support with the development of a solution to Supplier of Last Resort (SoLR) claims arising from the financial pressures on gas suppliers

Key Board decisions

- Approval of continuing investment in our Cyber Security Programme to help meet government and regulatory requirements and National Cyber Security Centre standards
- Approval to increase political engagement on key issues such as decarbonisation and consumer vulnerability
- Agreement to re-purpose the Company's unused fuel poor network extension scheme allowance to support vulnerable customers

Scotland Gas Networks Plc (Registered number: SC264065)

Strategic Report for the Year Ended 31 March 2023

SHAREHOLDERS AND DEBT INVESTORS

We have a solid shareholder base, made up of large infrastructure and pension funds, and a large and diverse debt investor base across public bonds, private placements

Why we engage

Understanding our shareholders' and debt investors' needs helps us access a cost-effective, stable, diversified financing base for the business. This also ensures we have access to low-cost debt and equity capital to support growth, which delivers long-term value for existing and future customers.

How we engage

- Annual General Meeting (AGM)
- Board representation and dedicated sub-committees
- Regular and ad hoc bilateral meetings with shareholders and debt investors
- Annual results presentations for debt investors
- Regular and ad hoc meetings with our three rating agencies

Stakeholder issues raised

- Delivery of Energy Futures initiatives
- Driving 'best-in-class' safety performance for employees and customers
- Stable, risk-adjusted investment returns for shareholders and debt holders
- Continued efficient investment

Outcomes of engagement on key decisions

- 2022 AGM attended by the Board with new shareholders. All resolutions passed.
- New Board Director appointments
- Awareness that the priorities and strategic imperatives of shareholders will not all be the same. The Board aims to understand the views of shareholders and to act fairly as between members of the Group.
- Dedicated strategy sessions for Energy Futures, RIIO - GD3 and annual safety review were held
- Liaising with shareholders to discuss ESG and TCFD strategy

Key Board decisions

- Approved H100 Energy Futures investment
- Approved the additional resourcing plan
- Targeting stable credit ratings
- Formation of the Nomination Committee
- Appointment of Key Executives to drive strategy and the company vision
- Dividend payment
- Support and engagement with the Company's approach to the TCFD reporting requirements

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2023**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 2023	Year ended 31 March 2022
Revenue	Income relating to the transportation of natural gas and provision of related services	£416m	£339m
Operating profit	Profit before financing costs and taxation	£161m	£108m
Capital expenditure [1]	Additions to fixed assets	£57m	£46m
Replacement expenditure [1]	Replacement expenditure is capitalised under FRS 102. It represents the cost of renewing sections of gas network with polyethylene pipes.	£71m	£54m
Net debt to RAV ratio [2]	The Company's net debt to RAV ratio	63.8%	69.5%
Employee lost time incidents	Incidents resulting in employees taking time off work (per 100,000 hours worked)	0.08 [3]	0.06 [3]
Customer satisfaction - planned interruptions	Results from customer satisfaction surveys(10 = very satisfied)	9.10 [4]	9.20 [4]

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2023**Key performance indicators - continued**

Key performance indicator (cont.)	Description (cont.)	Year ended 31 March 2023	Year ended 31 March 2022
Customer satisfaction - unplanned interruptions	Results from customer satisfaction surveys (10 = very satisfied)	9.60 [5]	9.54 [5]
Escapes attendance	Proportion of uncontrolled escapes attended in one hour - percentage (target 97%)	97.2%	98.1%
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.	50.0% increase [3]	15.0% increase [3]

- [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] Regulated Asset Value (RAV) is defined by our regulators. Net debt excludes shareholders' loans and liabilities arising from derivative financial instruments and is net of cash and cash equivalents. 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.

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2023**Alternative performance measures**

	APM 1: Net debt to Regulated Asset Value (RAV) ratio	APM 2: Capital expenditure	APM 3: Replacement expenditure
Closest equivalent UK GAAP measure	Borrowings	Tangible and intangible fixed asset additions	Tangible and intangible fixed asset additions
Adjustments to reconcile primary statements	Net debt (before issue costs), excluding shareholders' loans and liabilities arising from derivative financial instruments and net of cash and cash equivalents. RAV is as reported to Ofgem in the Regulatory Reporting Pack RRP. This does not have a statutory equivalent.	Tangible and intangible fixed asset additions excluding replacement expenditure	Tangible and intangible fixed asset additions excluding capital expenditure
Rationale for adjustments	Governed by specific licence conditions and covenants imposed on us due to the nature of the business.	This is an Ofgem driven performance measure. Due to the nature of the business, replacement expenditure is material to the financial statements and thus it should be disclosed separately.	This is an Ofgem driven performance measure. 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 2023**Alternative performance measures - continued**

	APM 4: Regulated Asset Value (RAV)	APM 5: Cashflow after investing activities
Closest equivalent UK GAAP measure	Tangible and intangible assets	Operating cashflow
Adjustments to reconcile primary statements	RAV is as reported to Ofgem in the Regulatory Reporting Pack (RRP). This does not have a statutory equivalent.	Excluding interest paid and including net cash flow from investing activities.
Rationale for adjustments	Governed by specific license conditions due to the nature of the business.	Due to the nature of the business cash flow from core activities are considered to be operating activities and investment in our gas infrastructure.

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 199 full time equivalent employees at 31 March 2023 (2022: 236). 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 2023. The comparative figures presented are for the year ended 31 March 2022, as reported in the audited financial statements, unless otherwise stated.

Turnover for the year ended 31 March 2023 was £416m (2022: £339m). The majority of turnover was earned from charges made for the provision of gas transportation capacity as well as revenue based upon gas volumes transported in the year. The year on year increase is predominantly driven by an increase in our regulated revenue in line with the profile set out within our price control.

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2023

Profit for the year before taxation amounted to £83m (2022: £28m). The current year tax charge is significantly lower than the tax charge in the year ended 31 March 2022. 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 in the prior year 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 increased to £161m (2022: £108m), which was largely driven by the increase in turnover noted previously, and partially offset by increased operational costs linked to additional costs incurred in supporting the controlled and uncontrolled gas escapes' response efforts.

During the financial year the Company had a £279m RPI-linked public bond that matured in October 2022. The maturity was part-refinanced by a £100m CPI-linked loan put in place in March 2022, which was drawn in September 2022, with the remainder refinanced by £184m of fixed rate private placement notes issued in October 2022. £154m of this issuance was drawn in October 2022 with £30m drawn in March 2023. The Company has no scheduled debt maturities in the coming year.

The Company paid dividends of £23m (2022: £51m) during the year.

Capital expenditure (excluding replacement expenditure) during the year amounted to £57m (2022: £46m). The increase resulted from the phasing of spend over the RIIO-GD2 period. Capital expenditure is incurred to ensure that the networks continue to operate at minimum agreed pressures and that sufficient storage capacity is available to meet instances of peak demand, as well as when new connections or increased capacity are added to the networks.

Treasury policies and capital structure

The Company's operations are financed by a combination of equity and retained profits, bank 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.

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

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 surplus as at 31 March 2023 was £98m (2022: £145m). The Company's normal pension contributions remain at 37.3% in line with previous years. Until 31 March 2022 additional contributions were paid annually to repair the actuarial deficit in the defined benefit pension scheme, however from 1 April 2022 these deficit contributions are no longer payable (2022: £5m).

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.

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2023

The revolving credit facility totalled £360m for the Group (2022: £360m) and is in place until March 2025; as at 31 March 2023 £360m is undrawn (2022: £330m). During the year the commitment split between Southern Gas Networks plc and the Company for the Group's RCF was amended such that at 31 March 2023 the Company's committed revolving credit facility amounted to £20m (2022: £235m), which was undrawn (2022: undrawn).

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 £42m payable relating to financial instruments with bank counterparties (2022: £70m).

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.

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.

OPERATIONAL REVIEW**Safety****Injury performance**

The Company's overriding goal is to distribute gas safely and reliably and to ensure a safe workplace for its workforce with everyone striving towards eliminating injuries. This year the lost time injury performance rate increased to 0.08 injuries per 100,000 hours (2022: 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, increased to £71m (2022: £54m). In line with movement in capital expenditure, replacement expenditure has also significantly increased compared to the previous year. The increase in value was due to a rise in contractor rates.

Scotland Gas Networks Plc (Registered number: SC264065)Strategic Report
for the Year Ended 31 March 2023**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.

Due to an intense cold snap pre-Christmas resulting in unprecedented surge in calls, along with other contributing factors and despite our best efforts, the Company's engineers failed to meet the 97% target imposed by the Gas Transporter Standard Special Conditions D10 in relation to the time taken to respond to controlled gas escapes. This has been the first time in the Company's history to miss this target. During the year ended 31 March 2023 we attended 96.6% (2022: 99.5%) of controlled gas escapes within two hours. Based on historical cases from other Gas Distribution Networks, this is expected to result in a fine and as such an Operational target provision of £1m (2022: £nil) has been recognised in the year.

We have an action plan in place to ensure that Emergency Response KPIs are achieved in the coming year.

In relation to uncontrolled gas escapes, the Company's engineers continued to exceed Ofgem targets by attending over 97.2% (2022: 98.1%) of these within one hour.

Gas networks' regulation

The year ended 31 March 2023 was the second year of the RIIO-GD2 price control, which set the key elements of revenue, outputs and allowed returns until 31 March 2026.

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.

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:

Nick Salmon

B044CB5BCEE1453.....

Nicholas Robin Salmon (Chair) - Director

Date: 27-07-23 | 11:54 AM BST

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report
for the Year Ended 31 March 2023

The Directors present their report and the audited financial statements for the year ended 31 March 2023.

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 £23m (2022: £51m). The Directors do not recommend the payment of any final dividend for the year (2022: £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 2022 to the date of this report.

Charlotte Brunning
Paul Jeffery
Charles Thomazi (Alternate)
Laura Sandys
Nicholas Robin Salmon (Chair)
Michael Botha
Rebecca Lumlock
Felipe Ortiz
Paul Trimmer
Martin Catchpole

Other changes in directors holding office are as follows:

Christian Fingerle - appointed 27 May 2022
Michael Oswald Smart - appointed 27 May 2022
Antoine Kerrenneur - appointed 29 March 2023
Jeffrey Rosenthal - appointed 14 June 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 2023**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. 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 around 35% of its debt portfolio in inflation linked. The Company also uses inflation-linked swaps, where necessary, to achieve this profile. This policy is kept under review and is updated as deemed necessary by the Board.

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 covenants and Company policy, should the Company decide to raise finance in currency other than Pound Sterling, cross currency swaps would be used to fully hedge all non-Sterling denominated 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, short-term liquid funds and committed facilities, in order to ensure that there are sufficient funds available for the Company's current and planned operations.

Credit risk

The Company transacts with banks for the provision of interest rate and inflation rate hedging transactions. The Company takes reasonable steps to maintain a minimum credit rating requirement as set out in its hedging policy. In respect of short-term cash management, counterparties are subject to review and approval according to defined criteria. Trade receivables predominantly relate to transportation income from gas shippers. Credit risk arising from the Company's regulated business is managed in accordance with industry standards as set out by the Unified Network Code.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report
for the Year Ended 31 March 2023

Pricing risk

The Company's gas transportation charges are subject to price control formulae set within the regulatory regime. The Company's maximum allowed revenue in a given price period is dependent upon a number of factors that are not known in advance and therefore the maximum allowed annual revenue is not known until the end of the relevant period.

However, transportation tariffs are set on a prospective basis based upon expected transportation volumes, so actual revenue received or receivable in any one year may differ from the maximum allowed revenue. Where revenues received or receivable differ from the maximum allowed annual revenue, adjustments are made to future prices to reflect this over or under recovery.

EMPLOYEES

The Company places considerable value on the involvement of its employees. 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 2024 (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 the going concern period, being twelve months (to 31 July 2024) from the date of approval of this report. Accordingly, the Directors continue to adopt the going concern basis in preparing the financial statements.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2023**ENVIRONMENT AND SUSTAINABILITY**

The Financial Stability Board (FSB) created the Task Force on Climate related Financial Disclosures (TCFD) to improve and increase reporting of climate-related financial information. As per Companies Act (2006), for companies with >500 employees and >£500m turnover, it is mandatory to report in alignment with TCFD for periods beginning on or after 6 April 2022. This is not yet relevant for Scotland Gas Networks plc, however a TCFD report has been included in the Annual Report of the ultimate parent undertaking, Scotia Gas Networks Limited, which is available from St Lawrence House, Station Approach, Horley, Surrey, RH6 9HJ, United Kingdom.

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

	2022/23		2021/22		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)	414	1.00	370	1.09	(44)	0.09
Transport (direct commercial vehicles and business miles)	6,828	16.45	8,407	24.80	1,579	8.35
Scope 2						
Electricity consumption	12	0.03	44	0.13	32	0.10
Scope 3						
Rail, air and ferry travel	10,637	25.63	4,992	14.73	(5,645)	(10.90)
Total (excluding shrinkage)	17,891	43.11	13,813	40.75	(4,078)	(2.36)
Shrinkage	182,926	440.79	190,984	563.37	8,058	122.58
Total carbon emissions	200,817	483.90	204,797	604.12	3,980	120.22

Data has not been independently verified. Data provided here is in line with annual regulatory reporting of carbon footprint to Ofgem using Defra conversion factors. Conversion factors are updated annually. Where market-based factors are stated these are provided annually by our electricity suppliers. Total annual net emissions figure uses market-based methodology.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report
for the Year Ended 31 March 2023

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 Company's carbon footprint accounting for 90.7% (2022: 92.9%). Reducing shrinkage therefore has the largest effect on reducing our carbon footprint. Over the year the Company have achieved a 4.2% reduction in natural gas shrinkage (2022: 3.5%) which equates to 8,058 tonnes of CO₂ equivalent (2022: 7,026). 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.

We are now powering approximately 98% of our offices with certified renewable electricity. This is shown through the very low market-based emissions for our Scope 2. We have a programme in place to install direct feed renewables which will reduce our location-based emissions Scope 2 over the coming years.

Our business travel has increased this financial year compared to last, as travel has resumed with lifting Covid-19 restrictions. It is worth noting that our business travel emissions are much lower than they were pre-pandemic. Using technology and video calls have become more embedded in our ways of working.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2023**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. Employee Engagement - A statement on how Directors have engaged with employees and how Directors have had regard to employee interests.
2. Stakeholder Engagement - A statement on how directors have engaged with stakeholders and how directors have had regard to stakeholder interests.
3. 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.
4. Corporate Governance - A statement on the Company's Corporate Governance Arrangements and how these have been applied.

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.

Wates Principles

For the year ended 31 March 2023, under the Companies (Miscellaneous Reporting) Regulations 2018, the Company 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 its website under www.frc.org.uk/directors/corporate-governance-andstewardship/governance-oflarge-private-companies.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report for the Year Ended 31 March 2023

The Wates Principles provide a framework for the Board to monitor corporate governance of the Company 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 Company. Throughout FY 2023/24, the Board will continue to review and challenge how the Company can continue to improve its corporate governance.

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.

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 2023:

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.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report
for the Year Ended 31 March 2023

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, the Company's employees, the Executive Committee and the Board were engaged to establish the refreshed purpose, vision and values as represented above. More than 1,300 colleagues were involved in this engagement programme. Looking ahead we will be developing our strategy out to 2030 to underpin our purpose, vision and stand as an organisation.

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 across the Company 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 Company 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.

At the start of the financial year, the newly appointed six Directors undertook a comprehensive induction programme. These Directors bring a wealth of experience and come from a range of backgrounds. The Board continues to remain committed to improving diversity throughout the Company in terms of gender, ethnicity, disability and age. This matter falls within the remit of the Board however its newly formed Board sub-committee, the Nomination Committee, actively engages with the shareholders to ensure that diversity remains a key objective for the selection and appointment of Directors.

The Board also re-appointed the two Independent Non-Executive Directors for an additional term, following consideration and satisfaction that they continued to meet the criteria set out in Gas Transporter Licence Standard Special Condition A42 and provision 10 of the Corporate Governance Code by demonstrating ongoing objectivity and continuing to provide valuable contribution based on their extensive experience and backgrounds.

In 2023/24 we propose to complete a Board skills audit to understand any gaps that we may need to close.

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.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2023

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 Board's decision-making process.

The Board continues to be supported by the work of the Board Committees. The Board Reserved Matters continues to be rolled out, to ensure the balance of responsibilities, accountabilities and decision making is maintained between the Executive Committee and the Board.

In FY 2023/24, a Board effectiveness review will be undertaken now that the new Board has become fully embedded. 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 key principal risks and received bi-monthly updates on those with a high residual risk rating. The Board also reviewed key investment opportunities. Our key principal risks are to be fully reassessed and associated risk appetite considered in the first half of 2023/24 with the Board.

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 newly formed Remuneration Committee (previously the People & Reward Committee) has clearly defined terms of reference and is responsible for making recommendations to the Board concerning the Company'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 Company's resources by securing and retaining quality people who can deliver our purpose, vision and values and long-term goals for its existing and future stakeholders.

In FY 2022/23, the Board (following a recommendation from the Remuneration Committee) approved annual salary reviews of all personal service contract employees and agreed both the short-term and long-term incentive plan frameworks for the financial year and the three-year period starting April 2023 ensuring these frameworks measured both financial and non-financial performance.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report
for the Year Ended 31 March 2023

In 2023/24 we plan to review the performance and reward structure of the Executive and wider group to ensure it reflects the strategy out to 2030.

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 Company. The Board is committed to social responsibility, community engagement and environmental sustainability as underpinned by our strategic priorities.

Our Stakeholder, Environment, Social & Governance Committee (SESG) 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.

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.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report for the Year Ended 31 March 2023

Roles and responsibilities for each Board Member, Chief Executive Officer, Chief Financial Officer and Group Company Secretary can be found on page 53 followed by their biographies on pages 54 to 56.

Board Committees

During the year the Board was directly assisted in the discharge of its duties by six Board Committees, 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 43 to 50.

Board effectiveness

At the start of the financial year and as part of the ownership change at the Company's ultimate parent undertaking, Scotia Gas Networks Limited, the Company welcomed its newly appointed Board of Directors. Within the first six-month period, the Chair, Interim Company Secretary and Chief Executive Officer took the opportunity to obtain the Board's initial feedback on Board and Committee effectiveness, including areas such as Board paper quality, timeliness, Board meetings and engagement. As the Board Directors are now fully embedded in their roles and the Company, we will undertake a full Board and Committee performance effectiveness review and act on findings to ensure the highest standards of corporate governance.

Chief Executive Officer and Chief Financial Officer

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

Executive Committee

In FY 2022/23 the decision was made to split the Executive Committee into two forums, the Operational Executive Committee, and the Strategic Executive Committee. This was to ensure that the appropriate level of focus was given to Operational Performance and Strategic Planning respectively. The day-to-day management of the Company is delegated to these Committees, which meet monthly and is chaired by the Chief Executive Officer and whose membership includes the Chief Financial Officer and leaders of each business unit. Both Committees are in turn supported by their 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.

Scotland Gas Networks Plc (Registered number: SC264065)**Directors' Report**
for the Year Ended 31 March 2023

The Group Company Secretary has commenced work with Board Intelligence Limited to look at refreshing the Board and Committee paper templates, and the CEO report. As part of this, refresher training to paper authors on best practice paper writing to support the provision of high-quality information and effective decision making will be arranged. This exercise will involve reinforcing the use of best practice paper templates, which seek to help focus the Board on what matters (including checks against its Section 172 duties).

During the year, the Company dashboard (displaying key performance data and rapid insights on the overall health of the Company) was reviewed and redeveloped to streamline reporting. Board information continues to be 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

The Company's ultimate parent undertaking, Scotia Gas Networks Limited has three supportive shareholders. The Board interacts with the shareholder members on a regular basis and always acts fairly with members of the Company.

Board Meetings

There were six scheduled meetings of the Board in the year and two further Board calls in line with the agreed plan of business for the year, and details of Director attendance can be found on page 51 to 52.

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 six Board meetings and six Board update 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 undertook site visits and employee engagement sessions with a number of employees. The Board plans to resume stakeholder engagement sessions going forward.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2023**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.

The Board has also spent a significant time considering its strategy over the next five years with dedicated strategy sessions. As part of this, the Board has overseen a number of other strategy-related analyses, including, but not limited to: a review of the Company's pathway to the decarbonisation of heat, covering relevant trends in policy, technology, customer and stakeholder expectations; the Company's long-term financial outlook; assessment and prioritisation of growth opportunities; and a review of key risks.

Further details of the areas which have shaped the Board and Committee agendas during 2022/23 are set out below:

Board Focus	Detailed description
Strategy	<ul style="list-style-type: none"> - Supplier of Last Resort (SoLR), Third-Party Finance & Tariffs: consideration and approval of the SoLR and third-party finance strategy, and tariffs. - Customers: received and provided feedback on progress against the customer strategy and RIIO - GD2 customer experience programme to ensure RIIO - GD2 business plan requirements are met and maintain positive customer experience. - Cyber Security & IT Resilience: continued to review IT resilience across the business and approved the ransomware policy. - Energy Futures: reviewed the Energy Futures strategy covering the strategic framework, non-regulated activities, delivery of the strategy and future developments. - ESG Reporting Framework: received an overview of ESG disclosures forming part of the World Economic Forum's Stakeholder Capitalism Metrics adopted by the Company's as the ESG reporting framework.

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 (including standards of service), initiatives and RIIO - GD3 planning.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report
for the Year Ended 31 March 2023

Board Focus **Detailed description (cont.)**
(cont.)

- Safety performance: the Board engaged significantly in monitoring, providing support and feedback with the development of the Safety Programme and performance initiatives, this included a dedicated additional safety deep dive session and continued Board site visits.
- Stakeholder: continued Board focus and review of stakeholder performance and initiatives, including receiving and reviewing the annual Customer, Stakeholder & Engagement Group report.
- Operations & Network: Deeper review of the Company's Operations and Network performance and initiatives. The Board also continue to closely monitor and discuss operational performance during the regular updates received against the Operations programme during the CEO Board update calls and Board meetings.
- Large projects and investments: review of progress against significant projects and investments, including H100 Fife.
- Employees: Received and provided feedback on SGN's Great Place to Work survey and continued focus on engagement with employees through 'Let's chat' sessions and site visits. The Board regularly receive and closely monitor performance updates provided against the Resourcing Plan during the CEO Board update calls and Board meetings.

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 Company policies and compliance certificates in line with the Governance Framework, such as the insurance renewal, modern slavery statement, sanctions policy and code of conduct.
- Governance - review and approval of the changes to the Board committee's membership (following the onboarding of new Directors), terms of references and formation of the Nomination Committee.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report for the Year Ended 31 March 2023

Board Committees

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 Networks 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, Risk and Compliance, the Finance Director and the Head of Financial Reporting and Tax, 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 and approved the goodwill impairment and carrying value judgements.
- Reviewed the accounting treatment and provisions for key commercial projects.
- Received and discussed the key outcomes from the Financial Reporting Council's review of the Annual Report and Accounts for the year ending 31 March 2022.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report for the Year Ended 31 March 2023

External audit

- 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.

Internal audit

- Reviewed the outputs from the external quality assessment undertaken on the Internal Audit function.
- Approved the annual audit plan and received regular updates on the delivery of the plan.

Risk management and internal controls

- Approved the annual compliance plan 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 Company.
- Received external compliance report on compliance with standard licence condition A27 concerning business separation and approved submission to Ofgem.

Regulatory filings and governance

- Approved the Debt to RAV and compliance certificates for Scotland Gas Network plc.
- Monitored the level of non-audit fees and approved any new non-audit services.
- Reviewed the Data Assurance Guidelines for the Company.
- Reviewed the Prompt Payment Code return for the Company.

Looking forward

The Committee's priorities for Financial Year 2023/24 are continuing to develop and improve our internal controls and assurance processes, with input from our internal and external auditors. The Committee will also monitor any proposed changes to the accounting standards adopted by the Company, to assess the impact and ensure compliance.

Finance Committee

Membership

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

Attendees

The Chief Financial Officer, Finance Director 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;
- policies for the operation of bank accounts and facilities, including appointment of authorised personnel to those accounts and facilities; and
- policies for granting guarantees, indemnities, any type of parent-company support or security interest.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report for the Year Ended 31 March 2023

In addition, the Finance Committee will review and approve investments or transactions where the Finance Committee has been delegated authority by the Board to do so.

What the Committee has done this year

The Finance Committee held six meetings during the financial year of which three were additional to the planned. 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 and approved the EMTN programme base prospectus and associated transaction documents.
- Considered and approved new financing and risk management strategies for the Company's near-term refinancing requirements.
- Reviewed and approved a strategy to manage the mandatory break in one of Scotland Gas Networks plc's interest rate swaps.
- Approved the commissioning of a capital restructure analysis.

Governance

- Reviewed and supported Management's proposal with regards to the Public Benefit Infrastructure Election.
- Reviewed and approved an update to the Treasury manual and bank and Treasury mandates.
- Received and discussed the Treasury audit findings.

Looking forward

The Committee's priorities for FY 2023/24 are to monitor the implementation of funding and financial risk management strategies approved in FY 2022/23 to ensure the Company 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 upcoming funding maturities to ensure that these are managed to maintain an appropriate funding profile and liquidity position.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report for the Year Ended 31 March 2023

Remuneration Committee

Membership

The current members of the Remuneration 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 Remuneration Committee meetings to represent Management.

The role of the Committee and principal responsibilities

The Remuneration Committee is a sub-committee of the Board. The Remuneration 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 Executive performance, having regard to statutory and regulatory requirements;
- talent and succession strategy for the Company's Executive is suitable for the Company's long-term success;
- diversity and inclusion play a key role across the Company; and
- employee feedback is listened to and acted on.

What the Committee has done this year

The Remuneration 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 development of the Company's resourcing plans designed to reinforce future resilience. These include the recruitment of significant numbers of frontline operational employees (including trainees and apprentices).
- Approved the annual salary review of all employees for cost of living increases.

Performance

- Reviewed and agreed short-term incentive plan (STIP) targets for the Financial Year, and long-term incentive plan (LTIP) targets for the three-year period ending 2025, ensuring both included a balanced scorecard of financial and non-financial performance.
- Approved the performance assessments for STIP for the prior Financial Year, and for LTIP for the 3-year period ending 31 March 2022.
- Reviewed and approved personal objectives for the Chief Executive Officer and Chief Financial Officer and assessed prior year performance.
- Reviewed the succession plan for Executive Directors and other critical roles.
- Reviewed the results of the 2022 'Great Place survey' (engagement), and action plans.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report for the Year Ended 31 March 2023

Governance

- Reviewed latest internal reward benchmarking results for Executive, senior and critical employees.
- Reviewed the Diversity & Inclusion Strategy.
- Monitored the recruitment process and appointment of the new CEO (Mark Wild).

Looking forward

The Committee's priorities for FY 2023/24 are to ensure the success of the Company's resourcing plans designed to reinforce future resilience, that the talent and succession strategy for the Company's Executive is suitable for the Company's long-term success and ensure diversity and inclusion continues to play a key role across the Company. The Committee will also review the reward strategy for the Company's Executive and senior/critical employees to ensure appropriate levels of incentivisation.

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 sub-committee 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.

- 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: receive a comprehensive health and safety report for HSC committee; safety performance review and key updates in the CEO report and significant incident notifications from the CEO.
- Act: receive an annual review of health and safety at the HSC; conduct Board member and Executive team site safety visits; and update on external audit reports to provide HSC assurance.

What the Committee has done this year

The Health & 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.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report for the Year Ended 31 March 2023

Key highlights

The key highlights for the year were:

Strategy

- Reviewed the project to update and transform the safety management framework.
- Received and discussed the Safety Programme.

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 the Fatigue programme performance.
- Reviewed compliance and assurance plans, including external assurance activity.
- Reviewed the Company's winter readiness and road traffic improvement plan.
- Received and discussed the safety benchmarking data compiled by the ENA across GDNs.

Governance

- Reviewed and approved the Safety, Health and Environment Policy statement for FY 2022/23.

Looking forward

The Committee's priorities for FY 2023/24 are continuing to drive health and safety improvements ensuring that the Company achieves its commitment to getting everyone home safe and well. FY 2023/24 will see increasing focus on safety culture and a further drive in reporting and performance improvements for mental health and wellbeing. Also continued commitment across the Company for visible leadership through site engagements.

Stakeholder, Environment, Social and Governance Committee

Membership

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

Attendees

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

The role of the Committee and principal responsibilities

The Stakeholder, Environment, Social and Governance Committee is a sub-committee of the Board. The Stakeholder, Environment, Social and Governance Committee's principal role is to support the Board in ensuring its Directors and the Company have due regard to:

- Cultural, environmental, social and governance (ESG) issues;
- all stakeholders with an interest or concern in the Company; 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, risks and emerging ESG issues.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report for the Year Ended 31 March 2023

What the Committee has done this year

The Stakeholder, Environment, Social and Governance 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

- Received and discussed the ESG disclosure metrics forming part of the ESG reporting framework.
- Received the Committee's planned activities for the calendar year and provided feedback.
- Received the Company's long-term community strategy and provided feedback.
- Received and discussed the Company's Community Support Programme for winter FY 2022/23.

Performance

- Reviewed performance against the RIIO-GD2 reporting requirements.
- Reviewed performance of the Company's stakeholder, environment and customer engagement activities and provided feedback.
- Received the Annual Environmental Report project update.
- Received a performance update against the Company's ESG and sustainability approach.
- Received an introduction to TCFD and the Company's approach to the disclosure requirements.

Governance

- Reviewed Directors' duties under S172 of the Companies Act 2006.
- Re-named the Committee to the Stakeholder, Environment, Social & Governance Committee.

Looking forward

The Committee's priorities for financial year 2023/24 are to continue reviewing political engagement for the future of energy leading up to the UK Government's strategic decision on hydrogen in 2026 and to provide oversight of the support for fuel poor customers ensuring a just transition. The Committee will review the ESG & Sustainability vision and strategy including increased focus on interim and long-term greenhouse gas emissions target as well as opportunities and risks associated with climate change. The Committee will continue to oversee the Company's progress with ESG and TCFD matters and will consider stakeholder engagement in preparation for business plan submission for the RIIO-GD3 price control.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report for the Year Ended 31 March 2023

Nomination Committee

Membership

The current members of the Nomination Committee are Nick Salmon (Committee Chair), Michael Botha (as available), Rebecca Lumlock (as available), Jeff Rosenthal (as available), Martin Catchpole (as available), Paul Trimmer (as available), Charlotte Brunning (as available), Christian Fingerle (as available), Paul Jeffery (as available) and Laura Sandys (as available).

Attendees

The Chief Executive Officer and the HR & Services Director also attend the Nomination Committee meetings to represent Management.

The role of the Committee and principal responsibilities

The Nomination Committee is a sub-committee of the Board. The Nomination Committee's principal role is to support the Board by:

- Ensuring a formal, rigorous and transparent procedure is adhered to in the appointment of any new CEO/CFO or Independent Directors, to lead on the process for such appointments and make recommendations to the Board;
- Ensuring that the Board's composition is regularly reviewed and refreshed so that it is effective and able to operate in the best interests of its stakeholders;
- Reviewing and proposing the appropriate composition of Board committees and selection of Committee Chairs.

All decisions are recommended to the Board for approval.

What the Committee has done this year

The Nomination Committee held two 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:

Governance

- Formation of the Nomination Committee.
- Approved the appointment of the new Finance Committee Chair (Michael Botha).
- Approved the appointment of Jeff Rosenthal as Director and Felipe Ortiz and Antoine Kerrenneur as Alternate Directors to the Board.
- Reviewed the independence and approved the reappointment of the Sufficiently Independent Directors for Scotland Gas Networks plc as required under Standard Special Condition A42 of the Gas Transporters Licence and provision 10 of the Corporate Governance Code 2018.
- Reviewed and agreed changes to the Committee terms of reference.

Looking forward

The Nomination Committee's priorities for FY 2023/24 are to ensure that any changes in appointment to the Board are successfully transitioned to ensure the right balance of skills and expertise as well as diversity.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2023**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	Finance Committee meetings	Health and Safety Committee meetings
Directors				
Charlotte Brunning	6/6	-	6/6	-
Michael Botha	6/6	3/3	6/6	-
Martin Catchpole	6/6	3/3	6/6	-
Christian Fingerle	6/6	-	-	-
Paul Jeffery	6/6	3/3	6/6	-
Rebecca Lumlock	6/6	-	-	3/3
Felipe Ortiz*	3/3	-	-	-
Jeff Rosenthal*	3/3	-	-	-
Nicholas Salmon	6/6	3/3	-	3/3
Laura Sandys	6/6	-	-	3/3
Paul Trimmer	6/6	-	-	3/3

Notes to the tables above:

* - Jeff Rosenthal (previously Alternate Director) was appointed as a Director and Felipe Ortiz (previously Director) was appointed as Alternate Director on 24 November 2022.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2023**ATTENDANCE AT BOARD AND BOARD COMMITTEE MEETINGS - continued**

	Remuneration Committee meetings	Stakeholder, Environment, Social & Governance Committee meetings	Nomination Committee meetings**
Directors			
Charlotte Brunning	4/4	3/3	2/2
Michael Botha	-	-	2/2
Martin Catchpole	-	-	0/2
Christian Fingerle	-	-	2/2
Paul Jeffery	-	-	1/2
Rebecca Lumlock	4/4	3/3	2/2
Felipe Ortiz*	-	-	1/1
Jeff Rosenthal*	-	-	0/1
Nicholas Salmon	2/2	3/3	2/2
Laura Sandys	3/4	-	2/2
Paul Trimmer	4/4	3/3	2/2

Notes to the table above:

* - Jeff Rosenthal (previously Alternate Director) was appointed as a Director and Felipe Ortiz (previously Director) was appointed as Alternate Director on 24 November 2022.

** - Please find details regarding the membership of the Nomination Committee on Page 50.

Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Report
for the Year Ended 31 March 2023

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.

Chair

Responsible for leading the effective operation and governance of the Board:

- 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

Responsible for proposing and directing the delivery of strategy as agreed by the Board:

- 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

Responsible for:

- 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

Responsible for:

- 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

Responsible for the same responsibilities as Non-Executive Shareholder Directors, with the addition of:

- 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

Responsible for:

- 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
for the Year Ended 31 March 2023**Directors' and Senior Executives' Biographies and Responsibilities as at 31 March 2023****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 and Nomination 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 Holdco Limited, Apple Newco Limited, SGI and Scottish Hydro Electric Transmission plc. Charlotte serves as the Chair of the Remuneration Committee. She is also member of the Finance Committee, Nomination Committee and the Stakeholder, Environment, Social and Governance 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, Nomination 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 Remuneration Committee, Nomination Committee, the Health and Safety Committee and the Stakeholder, Environment, Social and Governance Committee.

Michael Botha, Non-executive Director

Michael joined the Board in March 2022 and is an Operating Partner 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, Nomination Committee and the Finance Committee.

Scotland Gas Networks Plc (Registered number: SC264065)Directors' Report
for the Year Ended 31 March 2023**Rebecca Lumlock, Non-executive Director**

Rebecca joined the Board in March 2022 and is an Operating Partner in Brookfield. She is also currently Interim CEO of Freightliner, the UK rail freight company. Prior to this she worked for Network Rail for five years including as the Managing Director for the Wessex Route, including London Waterloo. She was also their Group executive sponsor for gender. Becky 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 Remuneration Committee, Nomination Committee, the Health and Safety Committee and the Stakeholder, Environment, Social and Governance Committee.

Felipe Ortiz, Non-executive Director

Felipe joined the Board in March 2022 and is a Managing Director in Brookfield's Infrastructure Group, responsible for leading the origination and execution of European deals for Brookfield's Super-Core Infrastructure fund. Since joining Brookfield in 2009, Felipe has led multiple infrastructure transactions that include global investments in the utilities, transportation and telecom sectors. Prior to joining Brookfield, he worked in an investment bank in New York, providing M&A and capital markets advisory to infrastructure funds.

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 programme 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 Universität München. Christian is member of the Nomination Committee.

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, Scottish Hydro Electric Transmission plc, 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 2023**Antoine Kerrenneur, Alternate Director**

Antoine joined the Board in March 2023 and is a Principal at Global Infrastructure Partners (GIP) focusing on its energy, renewables and utility infrastructure investments. Antoine joined GIP at its inception in 2006, prior to which he spent four years in the Investment Banking division of Credit Suisse in London. Antoine is Director of the Board of Suez SA.

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 and Nomination 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. She is also director of Scottish Hydro Electric Transmission plc. Laura serves as the Chair of the Stakeholder, Environment, Social and Governance Committee and she's also member of the Remuneration Committee, Nomination Committee and the Health and Safety Committee.

Mark Wild OBE, Chief Executive Officer

Mark Wild joined SGN in August 2022 and has over 35 years of experience leading complex and critical infrastructure. Mark started his career in the electricity sector, but the majority of his experience has been in transportation, operating and building major infrastructure. Mark is the former Managing Director of Westinghouse Signals and was the CEO of Public Transport Victoria. Mark is the former Managing Director of London Underground and the former CEO of Crossrail, Europe's largest infrastructure programme. Mark serves as Independent Chair on the Transpennine Route Upgrade Board.

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 variety of financial, commercial and regulatory roles.

Nicola Shand, Chief of Staff and Director of Legal Services, Group Company Secretary

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

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 2023

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, will be proposed for re-appointment at the forthcoming Annual General Meeting.

BY ORDER OF THE BOARD:

DocuSigned by:

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Nicola Shand - Secretary

Date: 27-07-23 | 4:15 AM PDT
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Scotland Gas Networks Plc (Registered number: SC264065)

Directors' Responsibilities Statement
for the Year Ended 31 March 2023

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 2023 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 31 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 2023 and of its profit 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's 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 2024, and which includes details of facilities available, covenant calculations, and the results of management's scenario planning;

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

- 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;
- Challenging key assumptions within the forecasts with the assistance of our specialist teams and with reference to the RIIO-GD2 regulatory regime;
- Challenging management’s forecasts with reference to the audited results for the year ended 31 March 2023;
- Evaluated how these forecasts have been revised to reflect any impact 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;
- Evaluating the Group’s ability to undertake mitigating actions (including refinancing) and considering whether those actions are within the Group’s control and the timing of when they could be implemented; and
- Reviewing 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 2024) 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	➤ Valuation of the defined benefit obligation
	➤ Overall materiality of £3.7m which represents 5% of the company’s normalised profit before tax.
Materiality	➤ The profit before tax is normalised to exclude the accounting impacts of incremental FY 2023 revenue due to exceptionally high wholesale gas prices in the prior 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, the potential impact of climate change 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

Stakeholders are increasingly interested in how climate change will impact the Company. The Company has determined that the most significant future impacts from climate change on their 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. This is explained on page 8 in the principal risks and uncertainties. These disclosures form part of the “Other information,” rather than the audited financial statements. Our procedures on these unaudited 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, in line with our responsibilities on “Other information”.

In planning and performing our audit we assessed the potential impacts of climate change on the Company’s business and any consequential material impact on its financial statements.

The Company has explained in the “key source of estimation uncertainty” section of the financial statements on page 83 how climate change has been reflected in the financial statements. The principal areas of consideration by management include the useful economic life of the gas 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.

Based on our work we have not identified the impact of climate change on the financial statements to be a key audit matter or to impact a key audit matter.

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 (£242m; Prior year comparative £343m)</p> <p>Refer to the Audit Committee Report (page 10); Accounting policies (page 79); and Note 24 of the Financial Statements (page 100)</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>The risk has increased in the current year due to market volatility impacting the key assumptions including interest rates and inflation.</p>	<p>We performed the following audit procedures:</p> <ul style="list-style-type: none"> ➤ Performed walkthroughs of the pension of the Company's defined benefit obligation for the year ended 31 March 2023 to 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 within 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 2023; and ➤ Assessed the compliance of the related disclosures under FRS 102. 	<p>Based on the audit procedures performed, we consider the valuation of the defined benefit obligation for the year ended 31 March 2023 to be appropriate.</p> <p>The assumptions used in valuing the obligation were within acceptable EY ranges.</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

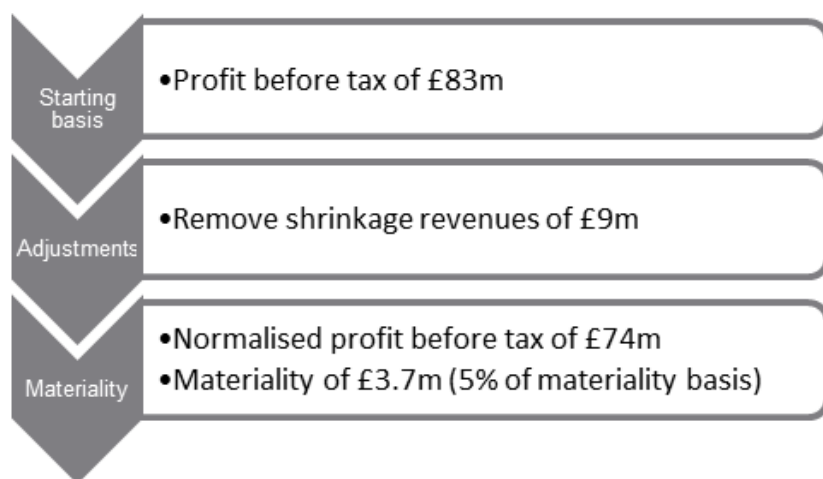
Our application of materiality

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 £3.7m (2022: £2.5m), which is 5% (2022: 5%) of normalised profit before tax so as to exclude the accounting impacts of incremental shrinkage revenues due to exceptionally high wholesale gas prices in the prior year. We believe that normalised 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 2023 forecast profit before tax to FY 2023 normalised profit before tax. We changed our basis to exclude the impact of transactions which are caused by fluctuating market conditions.

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.

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% (2022: 75%) of our planning materiality, namely £2.8m (2022: £1.9m). We have set performance materiality at this percentage following a quantitative and qualitative assessment of prior year misstatements and our assessment of the Group's overall control environment.

Reporting threshold

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

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

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.2m (2022: £0.1m), 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:

- 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.

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

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 58, 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.

- 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

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

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 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 3 years, covering the years ending 31 March 2021 to 31 March 2023.

- 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.

DocuSigned by:

Ernst & Young LLP

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Steven Dobson (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
Date: 27-07-23 | 5:28 PM BST

Scotland Gas Networks Plc (Registered number: SC264065)Profit and Loss Account
for the Year Ended 31 March 2023

	Notes	2023 £m	2022 £m
TURNOVER¹	3	416	339
Net operating costs ²		<u>(255)</u>	<u>(231)</u>
OPERATING PROFIT		161	108
Interest receivable and similar income	5	5	2
Interest payable and similar expenses	6	(89)	(69)
Fair value movement on derivatives	10	<u>6</u>	<u>(13)</u>
PROFIT BEFORE TAXATION	7	83	28
Tax on profit	8	<u>(20)</u>	<u>(79)</u>
PROFIT/(LOSS) FOR THE FINANCIAL YEAR		<u><u>63</u></u>	<u><u>(51)</u></u>

¹Included within Turnover are exceptional items to the sum of £9m (2022: £nil), see note 10 for more details.

²Included within Net operating costs are exceptional items to the sum of £nil (2022: £9m), 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 72 to 107 form part of these financial statements

Scotland Gas Networks Plc (Registered number: SC264065)Statement of Comprehensive Income
for the Year Ended 31 March 2023

	Notes	2023 £m	2022 £m
PROFIT/(LOSS) FOR THE YEAR		63	(51)
OTHER COMPREHENSIVE (LOSS)/INCOME			
Gain arising on cash flow hedges		27	15
Remeasurement on net pension asset		(47)	23
Income tax relating to components of other comprehensive (loss)/income		<u>5</u>	<u>(6)</u>
OTHER COMPREHENSIVE (LOSS)/INCOME FOR THE YEAR, NET OF INCOME TAX		<u>(15)</u>	<u>32</u>
TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR		<u><u>48</u></u>	<u><u>(19)</u></u>

The notes on pages 72 to 107 form part of these financial statements

Scotland Gas Networks Plc (Registered number: SC264065)Balance Sheet
31 March 2023

	Notes	2023 £m	2022 £m
FIXED ASSETS			
Intangible assets	11	102	106
Tangible assets	12	2,224	2,159
Non-current financial assets	13	<u>5</u>	<u>-</u>
		<u>2,331</u>	<u>2,265</u>
CURRENT ASSETS			
Debtors	14	93	42
Cash at bank	15	<u>38</u>	<u>25</u>
		131	67
CREDITORS			
Amounts falling due within one year	16	<u>(134)</u>	<u>(379)</u>
NET CURRENT LIABILITIES		<u>(3)</u>	<u>(312)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		2,328	1,953
CREDITORS			
Amounts falling due after more than one year	17	(1,472)	(1,182)
PROVISIONS FOR LIABILITIES	20	(343)	(337)
DEFERRED INCOME	21	(183)	(176)
PENSION ASSET	24	<u>98</u>	<u>145</u>
NET ASSETS		<u>428</u>	<u>403</u>
CAPITAL AND RESERVES			
Called up share capital	22	49	49
Hedging reserve	23	(21)	(41)
Profit and loss account	23	<u>400</u>	<u>395</u>
SHAREHOLDERS' FUNDS		<u>428</u>	<u>403</u>

The financial statements were approved by the Board of Directors and authorised for issue on 27-07-23 | 11:54 AM BST and were signed on its behalf by:

DocuSigned by:

Nick Salmon

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Nicholas Robin Salmon (Chair) - Director

The notes on pages 72 to 107 form part of these financial statements

Scotland Gas Networks Plc (Registered number: SC264065)Statement of Changes in Equity
for the Year Ended 31 March 2023

	Called up share capital £m	Profit and loss account £m	Hedging reserve £m	Total equity £m
Balance at 1 April 2021	49	481	(57)	473
Loss for the year	-	(51)	-	(51)
Other comprehensive income	-	16	16	32
	<hr/>	<hr/>	<hr/>	<hr/>
Total comprehensive (loss)/ income	-	(35)	16	(19)
Dividends	-	(51)	-	(51)
	<hr/>	<hr/>	<hr/>	<hr/>
Balance at 31 March 2022	49	395	(41)	403
	<hr/>	<hr/>	<hr/>	<hr/>
Profit for the year	-	63	-	63
Other comprehensive (loss)/ income	-	(35)	20	(15)
	<hr/>	<hr/>	<hr/>	<hr/>
Total comprehensive income	-	28	20	48
Dividends	-	(23)	-	(23)
	<hr/>	<hr/>	<hr/>	<hr/>
Balance at 31 March 2023	49	400	(21)	428
	<hr/>	<hr/>	<hr/>	<hr/>

The notes on pages 72 to 107 form part of these financial statements

Scotland Gas Networks Plc (Registered number: SC264065)Cash Flow Statement
for the Year Ended 31 March 2023

	Notes	2023 £m	2022 £m
Cash flows from operating activities			
Cash generated from operations	28	200	225
Interest paid		(41)	(43)
Tax paid		(14)	(13)
Net cash from operating activities		<u>145</u>	<u>169</u>
Cash flows from investing activities			
Purchase of intangible fixed assets		(3)	(3)
Purchase of tangible fixed assets		(123)	(98)
Customer contributions received		<u>11</u>	<u>9</u>
Net cash used in investing activities		<u>(115)</u>	<u>(92)</u>
Cash flows from financing activities			
Issue of debt		283	-
Repayment of debt		(279)	-
Payments of mirror swaps		-	(8)
Payments of interest rate swaps		(3)	(4)
Receipts from inflation-linked swaps		5	3
Dividends paid		<u>(23)</u>	<u>(51)</u>
Net cash used in financing activities		<u>(17)</u>	<u>(60)</u>
Increase in cash and cash equivalents		<u>13</u>	<u>17</u>
Cash and cash equivalents at beginning of year	29	<u>25</u>	<u>8</u>
Cash and cash equivalents at end of year	29	<u><u>38</u></u>	<u><u>25</u></u>

The notes on pages 72 to 107 form part of these financial statements

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements
for the Year Ended 31 March 2023**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 2024 (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 2023**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 the going concern period, being twelve months (to 31 July 2024) 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. Impairment indicators for goodwill are assessed on an annual basis at each balance sheet date, in line with FRS 102 requirements.

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 - 5 years.

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.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**1. ACCOUNTING POLICIES - continued**

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.

In line with the relevant accounting standards replacement expenditure is capitalised and the useful life is based on the range within mains and services above. Tangible fixed assets are derecognised on disposal, or when no future economic benefits are expected from its use or disposal. The carrying amount of any replaced component is derecognised. Major components are treated as separate assets where they have significantly different patterns of consumption of economic benefits and are depreciated separately over their useful lives.

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.

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.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**1. ACCOUNTING POLICIES - continued****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).

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.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**1. ACCOUNTING POLICIES – continued**

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

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

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

iv. Derecognition of financial assets

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

v. Trade debtors

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

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**1. ACCOUNTING POLICIES – continued**

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.

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 derivative financial instruments for risk management purposes.

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.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**1. ACCOUNTING POLICIES - continued**

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. The Company also uses inflation-linked swaps to hedge the risk arising from its inflation-linked asset base and revenues, 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.

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.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**1. ACCOUNTING POLICIES - continued**

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.

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 2023**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 2023**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 2023**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 - The Company incur significant staff and contractor costs for fulfilling normal business activities. Management judgement is required to allocate costs between capital, replacement and operating expenditure depending on the nature of the work being performed. Capital and replacement expenditure as reported in the Strategic Report on page 22 are both recognised as additions to plant and equipment within tangible fixed assets. Operating expenditure is recognised within Net operating costs within the Profit and Loss account.
- 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 levies are received. In relation to the SoLR mechanism, the Company does not hold inventory risk, does not set the SoLR mechanism pricing and is not exposed to credit risk. As such, it is management's judgment that the Company is acting as an Agent and therefore associated revenues and costs are not shown within Turnover or Net operating costs within the Profit and Loss account. The SOLR mechanism's only impact on the current and prior year financial statements is an immaterial balance originating from timing differences in payment and recovery, which is recorded in other creditors on the Balance sheet.
- e** Customer contributions - Cash inflows are presented as cash flows from investing activities in the Cash flow statement, as customer contributions are directly associated with capital investment in the Company's gas network.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**2. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY**
- continued**Key source of estimation uncertainty**

- a** Useful lives of assets - The Company 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
- 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.
- f** Operational target provision – During the year, the Company failed to meet the 97% target imposed by the Gas Transporter Standard Special Conditions D10 in relation to the time taken to respond to gas escapes. As at 31 March 2023 management considers the recognition criteria for a provision to have been met, as there is a probable future economic transfer resulting from the missed target. Significant management estimation is required to assess the quantum of the provision. Management used historical cases from other Gas Distribution Networks as the basis of the provision estimate.

3. TURNOVER

Analysis of turnover by class of business:

	2023	2022
	£m	£m
Transportation of natural gas and the provision of related services	416	339

All turnover arose in the United Kingdom.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**4. EMPLOYEES AND DIRECTORS**

The Company had 199 full time equivalent employees as at 31 March 2023 (2022: 236). The average monthly number of full-time equivalent employees during the year was 213 (2022: 250).

	2023	2022
Field based staff	102	117
Office and other administrative staff	97	119
	<u>199</u>	<u>236</u>

The Independent Directors received remuneration totalling £100,764 (2022: £99,324) 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 11 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.

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

	2023 £m	2022 £m
Wages and salaries	11	11
Social security costs	1	1
Pension costs (Note 24) ¹	12	12
	<u>24</u>	<u>24</u>

¹ Pension costs include the amount charged in respect of defined contributions schemes and the current service cost on the defined benefit scheme.

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 £47m (2022: £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

	2023 £m	2022 £m
Interest receivable on loans to other group undertakings	1	-
Net defined benefit pension income	4	2
	<u>5</u>	<u>2</u>

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**6. INTEREST PAYABLE AND SIMILAR EXPENSES**

	2023	2022
	£m	£m
Interest payable on fixed rate instruments	34	28
Interest payable on floating rate instruments	5	1
Interest payable on inflation-linked instruments	50	35
Other interest payable	-	5
	<u>89</u>	<u>69</u>

Included within interest payable on inflation-linked instruments is £47m of accretion on RPI-linked debt instruments (31 March 2022: £24m).

In March 2022, the Group 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, but which were removed in November 2020. The cash settlement amount of £4m is included within the interest paid line of the cash flow statement for the comparative period.

7. PROFIT BEFORE TAXATION

The profit is stated after charging/(crediting):

	2023	2022
	£m	£m
Depreciation - owned assets	60	58
Goodwill amortisation	3	3
Computer software amortisation	4	5
Amortisation of customer contributions	(4)	(4)
Rental under operating leases	<u>2</u>	<u>1</u>

Auditor's remuneration for the Company comprises:

- Audit of these financial statements £180,781 (2022: £147,300)
- Audit-related assurance services £52,500 (2022: £49,600)
- Other assurance services £28,000 (2022: £14,900)

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**8. TAXATION****Analysis of the tax charge**

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

	2023 £m	2022 £m
Current tax:		
UK corporation tax	11	8
Prior year adjustment	<u>(2)</u>	<u>(2)</u>
Total current tax	<u>9</u>	<u>6</u>
Deferred tax:		
Origination and reversal of timing differences	5	(2)
Prior year adjustment	3	(1)
Effect of change in tax rate	<u>3</u>	<u>76</u>
Total deferred tax	<u>11</u>	<u>73</u>
Tax on profit	<u><u>20</u></u>	<u><u>79</u></u>

UK corporation tax has been charged at 19% (2022 - 19%).

Reconciliation of total tax charge included in profit and loss

The tax assessed for the year is higher than (2022: higher than) the standard rate of corporation tax in the UK. The difference is explained below:

	2023 £m	2022 £m
Profit before tax	<u>83</u>	<u>28</u>
Profit multiplied by the standard rate of corporation tax in the UK of 19% (2022 - 19%)	16	5
Effects of:		
Adjustments to tax charge in respect of previous periods	1	(3)
Non-deductible goodwill	1	1
Effect of change in tax rates	3	76
Permanent benefit of capital allowances super deduction	<u>(1)</u>	<u>-</u>
Total tax charge	<u><u>20</u></u>	<u><u>79</u></u>

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**8. TAXATION - continued****Tax effects relating to effects of other comprehensive income**

	2023		
	Gross	Tax	Net
	£m	£m	£m
Gain arising on cash flow hedges	27	(7)	20
Remeasurement on net pension asset	(47)	12	(35)
	<u>(20)</u>	<u>5</u>	<u>(15)</u>

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

The standard rate of tax applied to reported profit on ordinary activities is 19% (2022: 19%). Finance Act 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 comparative period's 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 2023 by £3m (2022: £76m).

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 2023 amount to £23m (47.17p per share) (2022: £51m (102.65p per share)). No further dividends were proposed.

The dividends paid in the current year of £23m were paid in November 2022.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**10. EXCEPTIONAL ITEMS AND FAIR VALUE MOVEMENTS**

	2023 £m	2022 £m
Exceptional items included within turnover:		
Incremental turnover from recovery of costs due to increase in gas wholesale prices*	(9)	-
Exceptional items included within Net operating costs:		
Cost impact of increase in gas wholesale prices*	-	9
Included within taxation:		
Tax charge/ (credit) on cost impact of increase in gas wholesale prices	2	(2)
Fair value movements:		
Net (gains)/losses on derivative financial instruments**	(6)	13
Included within taxation:		
Tax charge/ (credit) on net losses on derivative financial instruments	2	(3)

*In the year, the Company recorded incremental turnover as a result of recovering incremental costs charged in the prior year of £9m (2022: nil) associated with the rise in wholesale gas prices through its regulated tariffs. These incremental costs were disclosed as exceptional items in the prior year and as such the associated income received in the current year is disclosed as such.

**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 the statement of comprehensive income.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**11. INTANGIBLE FIXED ASSETS**

	Goodwill £m	Computer software £m	Totals £m
COST			
At 1 April 2022	143	74	217
Additions	-	3	3
Disposals	-	(40)	(40)
At 31 March 2023	<u>143</u>	<u>37</u>	<u>180</u>
AMORTISATION			
At 1 April 2022	48	63	111
Amortisation for year	3	4	7
Eliminated on disposal	-	(40)	(40)
At 31 March 2023	<u>51</u>	<u>27</u>	<u>78</u>
NET BOOK VALUE			
At 31 March 2023	<u>92</u>	<u>10</u>	<u>102</u>
At 31 March 2022	<u>95</u>	<u>11</u>	<u>106</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 32 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 2023, 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 (2022: £nil).

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

During the year, the Company wrote off £40m of fully amortised assets, that are no longer in use, in line with the Company's accounting policy.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**12. TANGIBLE FIXED ASSETS**

	Freehold property £m	Plant and machinery £m	Motor vehicles and office equipment £m	Totals £m
COST				
At 1 April 2022	43	2,699	49	2,791
Additions	1	117	7	125
Disposals	-	(4)	(1)	(5)
At 31 March 2023	44	2,812	55	2,911
DEPRECIATION				
At 1 April 2022	13	587	32	632
Charge for year	1	55	4	60
Eliminated on disposal	-	(4)	(1)	(5)
At 31 March 2023	14	638	35	687
NET BOOK VALUE				
At 31 March 2023	30	2,174	20	2,224
At 31 March 2022	30	2,112	17	2,159

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

Included within Freehold property is the Net book value of land of £3m (2022: £3m).

13. NON-CURRENT FINANCIAL ASSETS

	2023 £m	2022 £m
Derivative financial instruments - interest rate swaps	5	-

14. DEBTORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2023 £m	2022 £m
Trade debtors	41	27
Amounts owed by group undertakings	34	-
Corporation tax	15	12
Prepayments and accrued income	3	3
	93	42

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**14. DEBTORS: AMOUNTS FALLING DUE WITHIN ONE YEAR - continued**

Amounts owed from group undertakings includes:

- an intercompany loan due from Southern Gas Networks plc of £67m (2022: £9m). 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 higher as at 31 March 2023 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.

This is partially offset by:

- intercompany trade balances due to the Group of £33m (2022: £23m).

15. CASH AT BANK

	2023	2022
	£m	£m
Cash at bank	<u>38</u>	<u>25</u>

Cash and cash equivalents contain £38m (2022: £25m) of cash which is contractually restricted to be used on designated innovation projects only and is not available for general use.

16. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2023	2022
	£m	£m
£165m 2.127% RPI-linked note due 2022	-	266
Trade creditors	44	29
Amounts owed to group undertakings	-	15
Social security and other taxes	7	6
Other creditors	5	3
Accrued interest	12	10
Deferred income	20	18
Accruals	<u>46</u>	<u>32</u>
	<u>134</u>	<u>379</u>

For details of Amounts owed to group undertakings see Note 14.

In the year ended 31 March 2021, the Company entered into an agreement with Ofgem to deliver a hydrogen gas pilot project in Scotland, known as the H100 Fife Project. In FY21 and FY22, the Company received £26m of upfront funding from the Scottish government, Ofgem and other Gas Distribution Networks, which was recorded as restricted cash and trade creditors on the balance sheet. Scotland Gas Networks plc subsequently entered into an intra-group arrangement with a fellow subsidiary of Scotia Gas Networks Limited, SGN Futures (H100) Limited, which is constructing the project on behalf of the entity. Scotland Gas Networks plc releases the funding to SGN Futures (H100) Limited in line with contractual terms, which is capped at £25m. As at 31 March 2023 Scotland Gas Networks plc holds £13m within Trade creditors and £25m within Cash at bank on the balance sheet in relation to the H100 project.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**17. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR**

	2023	2022
	£m	£m
Borrowings (see note 18)	1,430	1,112
Derivative financial liabilities –interest rate swaps	28	57
Derivative financial liabilities - inflation-linked swaps	14	13
	<u>1,472</u>	<u>1,182</u>

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

	2023	2022
	£m	£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
£34m 6.220% fixed rate note due 2032	34	-
£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
£30m 6.310% fixed rate note due 2035	30	-
£50m 6.220% fixed rate note due 2035	50	-
£70m 6.340% fixed rate note due 2037	70	-
	<u>966</u>	<u>782</u>

Inflation-linked debt:		
£50m -0.8818% CPI-linked loan due 2029	55	-
£50m -0.4465% CPI-linked loan due 2032	55	-
£125m 2.317% RPI-linked note due 2039*	209	185
	<u>319</u>	<u>185</u>

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
	<u>145</u>	<u>145</u>
Total debt	<u>1,430</u>	<u>1,112</u>

* Listed on the London Stock Exchange.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**17. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR - continued**

The above debt instruments are unsecured and are stated after the deduction of unamortised issue costs of £4m (2022: £3m). 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- and CPI-linked debt are not payable until the principal amount of the loans are repaid and are included within the carrying value of the debt stated above. Certain interest costs in respect of CPI-linked swaps are also not payable until the maturity of the swap.

The amount of interest in relation to the RPI- and CPI-linked debt included in the carrying value of the debt at 31 March 2023 is £85m (2022: £162m) and £10m (2022: £nil) respectively. The amounts recognised in the profit and loss account in relation to RPI- and CPI-linked debt accretion during the year amounted to £37m (2022: £24m) and £10m (2022: £nil) respectively.

The amount of interest in relation to the CPI-linked swaps included in the carrying value of the debt at the yearend is £21m (2022: £7m). The amounts debited to the profit and loss account in relation to these swaps' accretion during the year amounted to £14m (2022: £7m).

The Company's total revolving credit facility is £20m (2022: £235m) and expires in March 2025. The facility was undrawn at the year end.

18. BORROWINGS

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

	2023 £m	2022 £m
Between one and five years	347	347
After five years	<u>1,083</u>	<u>765</u>
	1,430	1,112
On demand or within one year	<u>-</u>	<u>266</u>
	<u>1,430</u>	<u>1,378</u>

19. 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.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**19. FINANCIAL INSTRUMENTS - continued**

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 assets and liabilities held by the company are as follows:

	2023	2022
Financial assets held at fair value		
Derivative financial instruments - interest rate swaps	5	-
Total financial assets held at fair value	5	-
Financial liabilities held at amortised cost	£m	£m
Trade creditors	44	29
Accrued interest	12	10
Accruals	46	32
Borrowings	1,430	1,379
	1,532	1,450
Financial liabilities held at fair value		
Derivative financial instruments - interest rate swaps	28	57
Derivative financial instruments - inflation-linked swaps	14	13
	42	70
Total financial liabilities	1,574	1,520

Valuation of derivatives

The Mark to Market ("MtM") value is calculated using a discounted cash flow method, which discounts the contracted future cashflows of derivatives using a risk-free rate (SONIA). The valuation is subsequently adjusted for the default risk of both the bank counterparty and the SGN entity respectively, by applying the CVA and DVA (together the "net credit risk adjustment").

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 £8m (2022: £5m), of which £4m (2022: £5m) related to inflation-linked swaps and £4m (2022: £nil) to interest rate swaps. £4m (2022: £5m) was credited to the profit and loss account in the line "Fair value movements on derivatives" and £4m (2022: £nil) was credited to other comprehensive income. The net credit risk adjustment was debited to "Derivative financial liabilities" within "Creditors: amounts falling due after more than one year" as presented in the balance sheet.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**19. FINANCIAL INSTRUMENTS – continued**

The net credit risk adjustment represents the risk of non-performance (or default) of either the counterparty or the Company in relation to financial instruments that require fair value measurements. These adjustments are respectively called Credit Value Adjustments ("CVA") and Debit Value Adjustments ("DVA").

The CVA and DVA are calculated by running two separate Monte Carlo simulations, based on the bilateral credit risk adjustment method. Quoted credit default swap spreads ("CDS") are used to determine counterparty credit curves when calculating the CVA. Z-spreads of senior unsecured public bonds are used to construct a credit curve for the Company when calculating the DVA.

The net credit risk adjustment is made up of a CVA of £1m (2022: £nil) and a DVA of (£9m) (2022: (£5m)). The magnitude of the DVA adjustment as at 31 March 2023 is mainly due to the asymmetric cash flow positions. SGN settle the inflation accretion to the counterparty at maturity on the swap, whereas the Group receive cash flows from the counterparty at every interest rate settlement date (every six months) through to maturity. The inflation linked swaps are long dated with remaining tenors of between 9-14 years, exacerbating the impact of the asymmetric cash flow position.

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 later replaced by permanent long-term capital markets debt. At that point the interest rate swaps became obsolete and consequently matching swaps were transacted (under which the Company received fixed rate interest) to close out the position. In March 2022 both sides of the 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 resulted in the elimination of any liability for the mirror swaps on the Company's balance sheet. The £6m cash settlement was recognised in the " payments of mirror swaps " line of the cash flow statement, within cash flows from financing activities.

Inflation-linked swaps

In the comparative period, 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.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**19. FINANCIAL INSTRUMENTS – continued****Interest rate swaps**

In October 2022, Scotland Gas Networks plc entered into three interest rate swaps totalling £90m that convert a portion of the £184m fixed rate notes, entered into within the same month, into floating rates based on SONIA:

- £30m of the £34m notes due 2032 converted from fixed to SONIA plus 2.115%, effective October 2022;
- £30m of the £30m notes due 2035 converted from fixed to SONIA plus 2.373%, effective March 2023;
- £30m of the £50m notes due 2035 converted from fixed to SONIA plus 2.2695%, effective October 2022.

In June 2022 the mandatory break on the Company's £80m IRS was extended by 10 years to March 2033. As part of this exercise, the swap was novated to another of the SGN Group's relationship banks and the fixed rate payable leg was increased by around 0.5%. The floating rate receivable was unchanged and remains the same as the floating rate payable on the hedged £80m floating rate bond due 2043.

In February 2023, the Company entered into a single £30m interest rate swap to 're-fix' the interest rate swap hedging the fixed rate notes due in 2032. The new swap's floating receive leg exactly offsets the original swap's floating pay leg, resulting in a net fixed exposure.

20. PROVISIONS FOR LIABILITIES

	2023 £m	2022 £m
Deferred tax	<u>327</u>	<u>321</u>
Other provisions	9	9
Environmental provisions	<u>7</u>	<u>7</u>
	<u>16</u>	<u>16</u>
Aggregate amounts	<u>343</u>	<u>337</u>
	Deferred tax	Other provisions
	£m	£m
Balance at 1 April 2022	321	16
Net movement in deferred tax	6	-
Utilised in the year	<u>-</u>	<u>-</u>
Balance at 31 March 2023	<u>327</u>	<u>16</u>

The discount unwind on environmental provisions, included in interest payable and similar expenses in the profit and loss account, was £231,321 (2022: £129,113).

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**20. 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 three years in line with anticipated regulatory outputs requirements for land remediation.

Other provisions

Other provisions consist of asbestos related liabilities and other provisions relating to the operations of our gas networks, including the Operational target provision, detailed in note 2. The other provisions represent management's best estimates of the future expenditure necessary to settle the obligations. The provision has been discounted and is stated at the present value of the estimated expenditure to settle the obligation. The asbestos related provision is expected to be utilised over the next 29 years. The other provisions relating to the operations of our gas networks are expected to be utilised in the next 2 years.

Deferred tax

Deferred tax is provided as follows:

	2023	2022
	£m	£m
Accelerated capital allowances	306	300
Deferred tax on cash flow hedges	(7)	(14)
Deferred tax on inflation swaps	3	(1)
Deferred tax on defined pension benefits	<u>25</u>	<u>36</u>
Deferred tax	<u>327</u>	<u>321</u>

The movement in provision for deferred tax is as follows:

	2023	2022
	£m	£m
Opening balance	321	242
Charged to profit and loss account	11	73
(Credited)/charged to other comprehensive income	<u>(5)</u>	<u>6</u>
Deferred tax	<u>327</u>	<u>321</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 2023**20. 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.

21. DEFERRED INCOME

	2023	2022
	£m	£m
Deferred income	<u>183</u>	<u>176</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
	2023	2023	2023
	£m	£m	£m
Customer contributions brought forward	104	72	176
Customer contributions deferred in the year	9	2	11
Amortisation in year	<u>(3)</u>	<u>(1)</u>	<u>(4)</u>
	<u>110</u>	<u>73</u>	<u>183</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.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**22. CALLED UP SHARE CAPITAL**

Allotted, issued and fully paid:

Number:	Class:	Nominal value:	2023 £	2022 £
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.

23. RESERVES

	Profit and loss account £m	Hedging reserve £m	Totals £m
At 1 April 2022	395	(41)	354
Profit for the year	63		63
Dividends	(23)		(23)
Movement in cash flow hedges	-	20	20
Remeasurement of net defined benefit asset	<u>(35)</u>	<u>-</u>	<u>(35)</u>
At 31 March 2023	<u>400</u>	<u>(21)</u>	<u>379</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.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**24. 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:

	2023	2022
	£m	£m
Amount charged in respect of defined contribution schemes	<u>6</u>	<u>5</u>

At the balance sheet date, there were outstanding contributions of £nil (2022: £nil).

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 2021. 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 Broadstone Corporate Benefits Limited at 31 March 2023 using the projected unit method.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**24. EMPLOYEE BENEFIT OBLIGATIONS – continued**

	As at 31 March 2023	As at 31 March 2022
Key assumptions used:		
Retail price inflation	3.5% p.a.	3.8% p.a.
Consumer price inflation	3.1% p.a.	3.4% p.a.
Rate of increase of pensions payment	3.5% p.a.	3.8% p.a.
Rate of increase of salaries	3.3% p.a.	3.6% p.a.
Discount rate	<u>4.7% p.a.</u>	<u>2.8% 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:

As at 31 March	2023		2022		2021	
	Male	Female	Male	Female	Male	Female
Members currently aged 65	22.3	24.7	22.8	24.4	22.7	24.3
Members currently aged 45	24.3	26.8	24.5	27.0	24.4	26.9

The approximate effects of movements in the key 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.	3,720 (3,640)
Price inflation (RPI measure)*	- 0.1% p.a. + 0.1% p.a.	(3,520) 3,400
Life expectancy	- 1 year + 1 year	(9,840) 10,280

*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.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**24. EMPLOYEE BENEFIT OBLIGATIONS – continued**

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

Fair value as at 31 March	2023			2022		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equities	-	-	-	51	-	51
Government bonds [1]	162	-	162	214	-	214
Corporate bonds	54	41	95	76	44	120
Property	-	-	-	-	-	-
Cash	-	4	4	-	4	4
Insurance contracts	-	79	79	-	99	99
Total market value of assets	216	124	340	341	147	488
Actuarial value of liabilities			(242)			(343)
Net pension asset			98			145

[1] Including LDI repurchase agreement liabilities.

The fair value of scheme assets at 31 March 2023 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 contributes to overall hedging levels for the Scheme of 95% for interest rates and 95% for inflation as at 31 March 2023 with respect to the pension scheme liabilities of £0.2bn (valued using the UK government bond yield curve). These LDI assets, which provide both interest rate and inflation protection, are managed by BlackRock and include a variety of instruments, including UK Government bonds (gilts), interest rate swaps, inflation swaps, gilt repos and corporate bonds. Further interest rate protection is provided by investment grade credit funds, including those managed by BlackRock and Goldman Sachs. The Scheme has also implemented pensioner buy-ins which contribute to the total interest rate hedging ratios referred to above.

After considering the Scheme's strong funding level and the advice of the Scheme's investment advisors, in March 2023 the Scheme's trustees agreed to undertake some further de-risking of the investment portfolio and fully sell out of all equity positions. The proceeds of the sale were invested into LDI assets initially, with a longer-term investment strategy for the proceeds to be agreed by the Trustees over the course of the 2023/24 financial year.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**24. EMPLOYEE BENEFIT OBLIGATIONS – continued**

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

	2023 £m	2022 £m
At 1 April	(343)	(375)
Current service cost	(6)	(7)
Interest cost	(9)	(7)
Actuarial gains	101	29
Benefits paid	15	17
	<u> </u>	<u> </u>
At 31 March	<u><u>(242)</u></u>	<u><u>(343)</u></u>

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

	2023 £m	2022 £m
At 1 April	488	494
Interest income	13	10
Contributions from the Company	3	8
Remeasurement of scheme assets	(148)	(6)
Benefits paid	(15)	(17)
Administration costs	(1)	(1)
	<u> </u>	<u> </u>
As at 31 March	<u><u>340</u></u>	<u><u>488</u></u>

The actual (loss)/ return on plan assets was:

	2023 £m	2022 £m
Loss on plan assets excluding interest income	(148)	(6)
Interest income on plan assets	13	10
	<u> </u>	<u> </u>
Actual (loss)/return on plan assets	<u><u>(135)</u></u>	<u><u>4</u></u>

Employer contributions for the period ending 31 March 2023 were 37.3% (2022: 37.3%) of monthly salary roll, before allowing for any salary sacrifice contributions. Deficit contributions were not payable from 1 April 2022 (2022: £5m p.a. from 1 April 2021 to 31 March 2022).

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**24. EMPLOYEE BENEFIT OBLIGATIONS – continued**

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

	2023 £m	2022 £m
Current service cost	(6)	(7)
Administration costs	(1)	(1)
Total charged to net operating costs:	(7)	(8)
Expected return on scheme assets	13	10
Interest charge on scheme liabilities	(9)	(7)
Net interest credit	4	3
Total charge to the profit and loss account	(3)	(5)

	2023 £m	2022 £m
Actuarial losses on scheme assets	(148)	(6)
Actuarial gains on scheme obligations	101	29
(Losses)/Gains recognised in other comprehensive income	(47)	23

25. FINANCIAL COMMITMENTS

Capital projects contracted for by the Company but not provided in the financial information amounted to £13m at 31 March 2023 (2022: £6m).

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

	Other		Land and Buildings	
	2023 £m	2022 £m	2023 £m	2022 £m
- less than one year	1	1	1	1
- between two to five years	1	1	4	2
- after five years	-	-	3	2

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**26. RELATED PARTY DISCLOSURES**

The Company is a subsidiary undertaking of SGN MidCo Limited. The ultimate controlling party of the Company 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.

Scotia Gas Networks Limited is owned by 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 funds managed by Global Infrastructure Partners (GIP).

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

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

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

During the year ended 31 March 2022, Scotia Gas Networks Limited underwent an ownership change and as such SSE plc ceased to be a shareholder and related party. In the year ended 31 March 2022, there were sales of goods and services amounting to £4m and purchase of goods and services of £(11m) between the Company and the SSE plc group of companies, in addition to interest charges relating to shareholder loans. Sales of goods and services to SSE primarily represented gas transportation services. At 31 March 2022 £nil was owed by SSE in relation to these services.

The Company had no transactions with shareholders or other related parties in the year ended 31 March 2023.

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**27. SUBSEQUENT EVENTS**

In May 2023, Scotland Gas Networks plc entered into a single £30m interest rate swap to 're-fix' the interest rate swap hedging the fixed rate notes due in 2035 that was effective in March 2023. The new swap's floating receive leg exactly offsets the original swap's floating pay leg, resulting in a net fixed exposure.

In June 2023, the commitment split between Southern Gas Networks plc and the Company for the Group's RCF was amended such that the Company's committed revolving facility has increased from £20m as at 31 March 2023 to £120m.

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

	2023	2022
	£m	£m
Profit before taxation	83	28
Depreciation charges	60	58
Amortisation of deferred income	(4)	(4)
Amortisation charges	7	8
Increase/ (decrease) in provisions	(1)	2
Interest payable and similar expenses	89	69
Fair value movement on derivatives	(6)	13
Interest receivable and similar income	<u>(5)</u>	<u>(2)</u>
	223	172
(Increase)/decrease in trade and other debtors	(59)	7
Increase in trade and other creditors and employee benefits	<u>36</u>	<u>46</u>
Cash generated from operations	<u><u>200</u></u>	<u><u>225</u></u>

Scotland Gas Networks Plc (Registered number: SC264065)Notes to the Financial Statements - continued
for the Year Ended 31 March 2023**29. ANALYSIS OF CHANGES IN NET DEBT**

	At 1 April 2022 £m	Cash flow £m	Other non-cash changes £m	At 31 March 2023 £m
Cash				
Cash at bank	<u>25</u>	<u>13</u>		<u>38</u>
	<u>25</u>	<u>13</u>		<u>38</u>
Debt				
Debts falling due within 1 year	(266)	279	(13)	-
Debts falling due after 1 year	<u>(1,112)</u>	<u>(283)</u>	<u>(35)</u>	<u>(1,430)</u>
	<u>(1,378)</u>	<u>(4)</u>	<u>(48)</u>	<u>(1,430)</u>
Derivative financial instruments				
Derivative financial assets	-	-	5	5
Derivative financial liabilities	<u>(70)</u>	<u>-</u>	<u>28</u>	<u>(42)</u>
	<u>(70)</u>	<u>-</u>	<u>33</u>	<u>(37)</u>
Total	<u>(1,423)</u>	<u>9</u>	<u>(15)</u>	<u>(1,429)</u>

30. MAJOR NON-CASH TRANSACTIONS

Other non-cash movements in borrowings relate to the amortisation of borrowing fees and loan accretion accruals.

31. 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).

In June 2022, the Company agreed to settle outstanding fees due in relation to certain guarantees provided by Assured Guarantee UK Limited that were previously in place over certain outstanding public bond instruments. The cash settlement amount of £0.2m is included within the "interest paid" line of the cash flow statement.