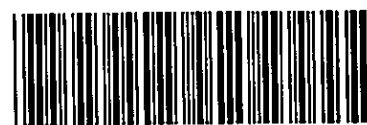


Southern Gas Networks plc
Annual Report
For the year ended 31 March 2012

Registered Number: 05167021

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Southern Gas Networks plc
Annual Report
for the year ended 31 March 2012
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Southern Gas Networks plc

Directors and advisers

Directors

Gregor Alexander
Stephen Dowd
Robert McDonald
James McPhillimy
Sebastien Sherman
Olivia Steedman
Natalie Bruce
John McManus

Secretary

Nicola Shand

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St Lawrence House
Station Approach
Horley
Surrey
RH6 9HJ

Registered auditor

Deloitte LLP
Chartered Accountants and Statutory Auditor
London

Registered number

05167021

Southern Gas Networks plc

Operating and financial review for the year ended 31 March 2012

This operating and financial review sets out the main trends and factors underlying the development and performance of the Company during the year ended 31 March 2012 as well as those matters which are likely to affect its future development and performance

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

The business, its objectives and strategy

The Company operates the regulated gas transportation business for the South and South-East of England gas distribution network, one of eight regional gas distribution networks in the United Kingdom. Its gas distribution network comprises approximately 49,000 kilometres of gas mains delivering natural gas to approximately 4.0 million domestic, commercial and industrial customers. The network stretches from Milton Keynes in the north, to Dover in the east and Lyme Regis in the west, including London boroughs to the south of the River Thames.

The Company is a wholly owned subsidiary of Scotia Gas Networks Limited ("SGN"). SGN is owned by a consortium made up of SSE plc, Borealis Infrastructure Europe (UK) Limited, which is indirectly wholly owned by OMERS Administration Corporation, and OTPPB Investments (UK) Limited which is owned by Ontario Teachers' Pension Plan Board. References to the "Group" throughout this Report mean SGN and its subsidiaries (including the Company).

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 of 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 risk through maintaining a minimum of 75% of debt at either fixed rates of interest or index linked.

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 in order 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.

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

Market climate

The UK is in a period where gas supply patterns are moving to a position where more reliance is placed on imported gas. The decline in UK continental shelf gas reserves and the UK energy policy taking cognisance of climate change is driving this shift towards greater use of imported gas.

Factors affecting the business

The 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**

As outlined above, the prices that can be charged for the use of the Company's networks are determined in accordance with regulator approved price controls. The outcome of the five-year review (in future eight years) baselined the revenues that will be obtained over the price control period. In addition, targeted incentive schemes were introduced by the regulator whereby the Company is able to earn additional revenues by outperforming the targets, or alternatively penalised if the Company does not meet them.

Additionally, the regulatory price controls include an allowed rate of return for the investment the Company makes in the network. The level of the allowed rate of return determines the extent to which investment to increase the quality and capacity of the network is economically viable.

- **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 index linked borrowings and by holding derivative financial instruments (interest rate swaps) where necessary to achieve the desired profile of interest rate risk.

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Principal risks and uncertainties

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

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

The Board reviews the principal risks and uncertainties facing the business and considers the risk management processes in place, which are designed to safeguard assets and to manage, rather than eliminate, material risks to the achievement of business objectives. These reviews recognise that any such process can provide only reasonable, and not absolute, assurance against material misstatement or loss. Further details of the processes the Board has in place are also set out in the Corporate Governance Statement on pages 15 to 18.

Stakeholders

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

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Key performance indicators

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

Key performance indicator	Description	Year ended 31 March 2012	Year ended 31 March 2011
EBITDA ¹	Earnings before interest, tax, depreciation and goodwill amortisation	£226.8m	£147.6m
Adjusted EBITDA ¹	EBITDA excluding replacement expenditure	£425.2m	£340.2m
Capital expenditure	Additions to tangible fixed assets	£84.3m	£84.0m
Replacement expenditure	The cost of planned maintenance of mains and services	£198.4m	£192.6m
Debt to RAV ratio ²	The Company's debt to RAV ratio	63.8%	67.3%
Employee lost time incidents	Incidents resulting in employees taking time off work (per 100,000 hours worked)	0.04 ⁵	0.05 ⁵
Customer satisfaction – planned interruptions	Results from customer satisfaction surveys (10 = very satisfied)	8.0 ³	7.9 ⁴
Customer satisfaction – unplanned interruptions	Results from customer satisfaction surveys (10 = very satisfied)	8.6 ³	8.4 ⁴
Escapes attendance	Proportion of uncontrolled escapes attended in one hour – percentage (target 97%)	98.7 ⁵	97.2 ⁵

1 EBITDA is a non-statutory measure, and is calculated by adding back goodwill amortisation and depreciation to operating profit.

2 "RAV" is defined as Ofgem Regulatory Asset Value plus additions in excess of current allowances expected to be recovered in future periods. Debt for the purposes of the Debt to RAV ratio excludes liabilities arising from derivative financial instruments. The percentages stated are as at 31 March 2012 and 31 March 2011 respectively.

3 Based on customer satisfaction survey reports obtained for the nine month period ended 31 December 2011 for the Group as a whole.

4 Based on customer satisfaction survey reports obtained for the nine month period ended 31 December 2010 for the Group as a whole.

5 This KPI is measured for the Group, and accordingly the data presented is that for the Group as a whole.

In considering financial performance, the Company uses EBITDA and Adjusted EBITDA. EBITDA is calculated by adding back goodwill amortisation and depreciation, which are non-cash costs, to operating profit. Adjusted EBITDA is calculated by adding back goodwill amortisation, depreciation and 100% of replacement expenditure to operating profit. Replacement expenditure that, under UK GAAP, is written off to the profit and loss account as it is incurred, improves the future safety and reliability of the network through the replacement of older gas pipes with modern pipes. Ofgem treats 50% of projected replacement expenditure as recoverable during the year and 50% as recoverable over future years. Accordingly, the Company believes the use of these adjusted measures best illustrates the underlying performance of the business.

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Resources

The Company's principal resources are its assets and its people

The Company's distribution network comprises approximately 49,000 kilometres of gas mains, together with associated services, plant and machinery and storage facilities

The Company had 978 full time equivalent employees at 31 March 2012 (2011 1,016) 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 in order 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 2012 The comparative figures presented are for the year ended 31 March 2011, as reported in the audited financial statements, unless otherwise stated

Turnover for the year ended 31 March 2012 was £635.8m (2011 £549.5m) and has increased in line with the regulatory settlement, investment levels and inflation 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

During the year the Company transported 93.2 Twh of gas, compared to 110.3 TWh in the year to 31 March 2011, representing a like for like decrease in volumes of 15.5% due to the milder winter weather

Profit for the year before taxation amounted to £27.7m (2011 loss for the year before taxation of £41.0m) and profit for the year after taxation amounted to £23.8m (2011 loss for the year after taxation of £29.9m)

Adjusted EBITDA for the year ended 31 March 2012 was £425.2m (2011 £340.2m) Adjusted EBITDA is calculated by adding back goodwill amortisation of £5.8m (2011 £5.7m), depreciation of £70.6m (2011 £67.8m) and replacement expenditure of £198.4m (2011 £192.6m) to reported operating profit of £150.4m (2011 £74.1m)

During the year the Company did not pay a dividend (2011 £52.8m)

Capital expenditure during the year amounted to £84.3m (2011 £84.0m) 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 borrowings and long term 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 on pages 12 to 14

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

As at 31 March 2012, the Company's total senior debt (before issue costs) amounted to £2,361.8m (2011 £2,206.4m) and the debt to RAV ratio was 63.8% (2011 67.3%) Of the total long term borrowings at 31 March 2012, after taking into account the effect of interest rate swaps, 90.5% were at either fixed rates of interest or were index linked (2011 82.0%)

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Pension commitments

A significant 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 17 (Retirement benefits) The net pension liability as at 31 March 2012 was £50.2m (2011 £29.1m) During the year the company paid special contributions of £14.1m (2011 £26.1m) Following the actuarial valuation carried out by the scheme's actuary as at 31 March 2009, with affect from 1 April 2010, annual special pension contributions were increased for the Group from £13.5m (Company's share £8.1m), to £23.5m (Company's share £14.1m) over the fifteen year period to 31 March 2025 Special contributions were agreed to repair the deficit in the defined benefit pension scheme The Company's normal contributions remain at 37.3%

Liquidity and cash flows

Liquidity is maintained through a mixture of long term borrowings and short term liquid funds in order that there are sufficient funds available for the 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 During the year a refinancing exercise was undertaken ahead of the start of the new price control review in April 2013 The Company issued a £300.0m 12 year fixed rate bond in September 2012 In addition, the Company renewed the revolving credit facility for a period of five years to December 2016 At 31 March 2012 the Company's committed undrawn revolving credit facility amounted to £200.0m (2011 £30.0m) The Company secured loan financing from the European Investment Bank in September 2010 of £100.0m which is was fully utilised in the previous year

Counterparty credit risk

The Company transacts with banks for the provision of interest rate and currency hedging transactions The Company maintains a minimum credit rating requirement of "A" or equivalent with its counterparties, however it recognises that at times the market conditions for banks can be unusually tight At the year end the Company had £8.1m receivable and £34.9m payable relating to financial instruments with bank counterparties

Dividend policy

The Company's policy is to distribute to its shareholder any available surplus funds, after taking into account the cash requirements needed to continue to invest in the business and the Company's level of gearing, and subject to the availability of distributable profits

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

Operational review

While the winter of 2010/11 was the worst on record, last winter was mildest for a number of years which had a positive effect on the Company's ability to respond to emergency calls and deliver its programme of capital, replacement and maintenance works Despite the good weather, over 178,000 emergency calls were received, each either requiring an immediate call from engineers or additional repair work to be carried out

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Projects

In 2010 Southern Gas Networks was the first Company in the UK to break the traditional form of gas delivery over recent years, with a landmark project in Didcot, Oxfordshire producing and delivering the first biogas into the gas distribution network. Following on from the success of Didcot, a second biomethane project is under construction in the eco-town of Poundbury, the Duchy of Cornwall owned estate near Dorchester, Dorset. The £2.3 million investment forms part of a joint-venture with JV Energen with the Company's contribution being to treat and enhance the biogas flowing from a new Anaerobic Digestion (AD) facility owned and operated by JV Energen. The bio-methane will then be delivered into the local gas distribution network with 800 cubic metres per hour of biogas flowing from the AD unit. The AD plant will be fuelled by 41,000 tonnes of locally secured feedstock including 5,000 tonnes of Potato food waste, 24,500 tonnes of maize, 10,000 tonnes of one-year grass and 2,000 tonnes of chicken manure. The Company's involvement in this project places it in a leading position in the UK's development of biomethane delivery.

A project to replace three high pressure gas pipelines from the mainland to the Isle of Wight was completed and commissioned along with a new pressure reduction station on the island at a total cost of £21.0 million. The previous pipes were laid in 1966 on the seabed of the Solent. These were replaced with two 300mm (12") diameter steel pipelines installed under the seabed via horizontal directional drilling techniques. The completed installation was marked by an opening ceremony in March 2012 when Isle of Wight MP, Andrew Turner, officially opened the pipeline and pressure reduction station. The project will provide a safe and secure gas supplies to 56,000 Isle of Wight homes and businesses for many years to come. In May 2011 the project team was presented with a gas industry award to recognise the work bringing the project to fruition.

Gas control

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

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

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 Company has reduced its lost time injury performance rate to 0.04 injuries per 100,000 hours (2011: 0.05).

During the year the Group received the 2011 Overall safety Achievement Award by the gas industry safety group (GISG), for its work in further improving safety across the industry.

Safety centres

During the year the Company engaged the 'in-footprint' members of Safety Centres UK, a network of facilities providing Safety learning opportunities for groups of 11-year-old schoolchildren. The aim is to continue working with these centres beyond the initial support provided, to develop further the facilities at each centre enabling them to advise and inform the children of danger, not only from

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carbon monoxide, but more generally from the Company's own operations in the delivery of gas to businesses and homes across the South and South East

Each centre is a separately registered charity and the funding the Company provides contributes to the continuing delivery of the safety to the children in their area. The Company's specific support has helped the centres provide training to some 13,000 children in the Bournemouth area, 4,000 in Oxfordshire and 21,000 in and around Milton Keynes. There is a plan to develop this further through the generation of a sustainable network of local support provided mainly by people from within the Company's own depot operations structure.

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 on page 17 in the Corporate Governance Statement.

Gas mains replacement programme

The Company has, in agreement with Ofgem and HSE, continued its extensive safety led programme of gas mains replacement across its networks to replace all iron pipes that are located within 30 metres of any property, which includes the replacement of the individual services connecting the premises to the mains network. The Company has a considerable amount of work to carry out and appreciates that this will inevitably cause some disruption. However, the polyethylene pipes being placed in the ground now, if left undisturbed, have a lifespan of at least 80 years, so when the work is complete, customers can expect to enjoy greater security of supply from a distribution infrastructure perspective. During the year, the Company has increased its investment in replacement activities to £198.4m (2011: £192.6m).

The Company is committed to working closely with the local authorities and police to plan its work so that the minimum amount of disruption is caused to residents, road users, businesses and traders. Wherever possible the Company uses modern, minimum-dig techniques, which allow the laying of gas mains without digging long trenches in the road, causing less impact on the environment and on the local communities.

Gas escapes standards of service

The Company's engineers respond to reports of suspected gas leaks 24 hours a day, 365 days a year, regardless of from whom people buy their gas. Its engineers aim to attend all uncontrolled gas escapes within one hour and all controlled gas escapes within two hours. A controlled gas escape is one where the person reporting it has confirmed that the gas emergency control valve serving the premises has been turned off and the smell of gas has gone. An uncontrolled gas escape covers all others. The Company's engineers exceeded Ofgem targets by attending over 97% of uncontrolled gas escapes within one hour.

Environment

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

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The 5O5 Campaign

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

- Reduce natural gas emissions,
- Reduce carbon emissions,
- Reduce the impact on landfill,
- Increase energy efficiency, and
- Reduce any wastage of materials

With these objectives the aim is to go beyond just complying with legislation There is a commitment to the protection and enhancement of the environment and to seek out new methods and practices to minimise the environmental impact of the Company

It is recognised that natural gas emissions are the Company's most significant contribution to climate change Each gram of methane (the main constituent of natural gas) is equivalent to about 21 grams of CO₂ Efforts to manage network pressures at optimum levels, coupled with replacement of old metallic mains with new plastic pipe, have meant the saving of around 172,000 tonnes of CO₂(e) since 2008

The SGN Group has invested in a new, more efficient, fleet of commercial vehicles and used satellite navigation technology to ensure the dispatch of engineers in an efficient manner This results in a reduction in diesel consumption and has saved around 2,320 tonnes of CO₂ emissions from the commercial fleet

In addition, since 2008, 240,000 tonnes of excavated spoil have been recycled and reused rather than disposed of as landfill This in turn has meant that the Company has avoided using more than 68,000 tonnes of virgin aggregate by backfilling excavations with recycled material These huge improvements in waste management have saved energy and reduced carbon emissions

Environmental recognition

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

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

It is hoped the action taken will allow the Company and its partners to demonstrate to the world that the UK gas industry is at the forefront of understanding, managing and reducing climate change

Future developments

Regulation

Ofgem have issued a new regulatory framework for the price control period commencing April 2013 The new price control is for a period of eight years and will see a greater focus on innovation, incentives and outputs Following extensive stakeholder engagements the Group submitted initial business plans to Ofgem in the autumn of 2011 Ofgem provided initial feedback on business plans in March 2012 and a response was submitted in April 2012 The final proposals from Ofgem are expected in December 2012 ahead of the start of new price control review from 1 April 2013

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Investment

Longer-term priorities include continued major replacement investment to replace metallic mains with polyethylene mains, a programme which has been developed in consultation with the HSE and Ofgem. In addition, continued major investment to upgrade the gas network is expected in order to meet instances of peak demand. The efficient and economic delivery of this capital investment will further increase the Company's RAV.

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 on its behalf by



Gregor Alexander
Chairman

20 July 2012

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Directors' report for the year ended 31 March 2012

The Directors present their report and the audited financial statements for the year ended 31 March 2012

Principal activities

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

Directors

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

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

Directors' insurance and indemnities

The Directors of the Company have the benefit of the indemnity provisions in the Company's Articles of Association. The Directors have been granted a qualifying third party indemnity provision which was in force throughout the year. In addition, 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.

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 operating and financial review on pages 2 to 11.

Results and dividends

The profit and loss account is set out on page 23, and is also reviewed on pages 5 and 6.

The Company did not pay any interim dividend (2011: £52.8m). The Directors do not propose payment of a final dividend (2011: £nil).

Financial risk management

The Company's funding, liquidity and exposure to interest rate and foreign exchange risks are managed within a framework of policies and guidelines 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 rates of interest or index linked. This policy is kept under review from time to time. The Company uses interest rate swaps, where necessary, in order to achieve this desired profile.

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Liquidity risk

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

Foreign exchange risk

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

Credit risk

Counterparty credit risks arising from financial derivatives are managed through the maintenance of financial limits, subject to a minimum credit rating of "A" or equivalent allocated by a recognised major ratings group. In respect of short term cash management, counter parties are subject to review and approval according to defined criteria

Trade receivables predominantly relate to transportation income from gas shippers. Credit risk arising from the Group's regulated business is managed in accordance with industry standards as set out by the Unified Network Code. The Group contracts with shippers having investment grade ratings only, or where suitable collateral or cash prepayments are made. Credit risk on amounts receivable from other Group companies is considered minimal

Pricing risk

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

Charitable contributions

The Company made charitable donations of £47,000 in the year (2011 £45,000) in support of community and employee initiatives across its operations. There were no political donations in either the current year or in the prior year

Employees

The Company places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the Company. Participation by employees generally is encouraged through team meetings, briefings, an internal newspaper and an intranet site. 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

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Creditors payment policy

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

- agree the terms of payment with those creditors/suppliers when agreeing the terms of each transaction,
- ensure that those creditors/suppliers were made aware of the terms of payment by inclusion of the relevant terms in contracts, and
- pay in accordance with its contractual and other legal obligations

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

At 31 March 2012, the Company had an average of 35 days (2011 24 days) outstanding in its trade creditors

Going concern

The Company's financial position, cash flows, liquidity position and borrowing facilities together with the factors likely to affect its future performance and the principal risks and uncertainties are set out in the Operating and Financial Review on pages 2 to 11. The financial risk management objectives and risk exposures are set out above.

As stated in the Operating and Financial Review the Company operates the regulated gas distribution networks in the South and South East of England. The revenue of the Company is regulated by Ofgem via established price control mechanisms based on the distribution network capacity. The Company has considerable financial resources together with committed financing facilities to finance the current and future operations. The Company's forecasts and projections, taking account of reasonably possible changes in trading performance show that the Company should be able to operate within the level of its current facilities. As a consequence, the Directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook. After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

Auditor

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

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

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

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

By Order of the Board



Nicola Shand
Company Secretary

20 July 2012

Southern Gas Networks plc

Corporate governance statement

The Board of Directors is the principal decision making forum for the Company and is committed to the highest standards of corporate governance. The Board believes that strong governance improves the performance of the Group and enhances shareholder value. This report sets out the key governance principles and practices of the Company and of the Group.

The Company, being unlisted, is not subject to the UK Financial Reporting Council's Combined Code on Corporate Governance¹ (the "**Combined Code**"), and the Board of Directors does not believe that all of the guidance set out in the Combined Code is applicable to the Company. However, for the purposes of this statement, the Directors have applied the Combined Code insofar as they believe it to be applicable.

Board of Directors

The Board of Directors is comprised entirely of non-executive Directors and is the principal decision-making forum for the Company. It has overall responsibility for leading and controlling the Company as well as its financial and operational performance.

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

The powers of the Directors are set out in the Company's Articles of Association. The Board has also adopted a formal schedule of matters detailing key aspects of the Company's affairs reserved to it for decision. This schedule is reviewed regularly. Furthermore, the Board has established three committees with specific responsibilities to ensure focused and effective leadership. Details of the committees are set out on page 16 and 17.

The Board meets regularly and held eight meetings during the year.

Board Constitution and Appointments

The Board consists of seven non-executive Directors in addition to the non-executive Chairman. The Board of Directors is the same for the Company and each Company within the Group.

Biographical details for each of the Directors are set out on page 19.

Chairman

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

Chief Executive Officer and Chief Financial Officer

Below the Board, executive responsibility rests with John Morea, Chief Executive Officer ("**CEO**") and Chris Brook, Chief Financial Officer ("**CFO**"). The CEO and CFO are each employed by the Group and are not Directors of the Company. They are supported by an executive committee which meets on a monthly basis and is responsible for managing the day-to-day operations of the Group.

Biographical details for the CEO and CFO are set out on page 19.

¹ The UK Corporate Governance Code was issued in May 2010 (replacing the Combined Code on Corporate Governance), applies to financial years beginning on or after 29 June 2010 and is available on the Financial Reporting Council's website (www.frc.org.uk).

Southern Gas Networks plc

Timeliness and quality of Board information

The Board has sought to ensure that Directors are properly briefed on issues arising at board meetings by establishing procedures for distributing board papers one week in advance of meetings, considering the adequacy of the information provided before making decisions, adjourning meetings or deferring decisions when Directors have concerns about the information available to them and making the Company Secretary responsible to the Board for the timeliness and quality of information

All Directors have access to the advice and services of the Company Secretary

Directors' remuneration

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

Conflicts of interest

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

The Board has put into place a procedure to consider any future actual or potential conflicts of interest that the Directors may have and will review the position regularly

Board Committees

In order to provide effective and focused leadership, the Board has established three committees with specific responsibilities. These are the Audit Committee, the People and Reward Committee and the Safety, Health and Environmental Advisory Committee, each of which meets regularly

Each Committee's performance, constitution and terms of reference are reviewed annually to ensure that they are operating effectively. The Company Secretary acts as secretary for each committee and further details are set out below

Audit Committee

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

The principal responsibilities of the Audit Committee are as follows -

- Ensuring that the Company's financial reports represent an accurate, clear and balanced assessment of the Company's position and prospects,
- Ensuring the economy, efficiency and effectiveness of the Company's operations and internal controls, the reliability and integrity of information and accounting systems, and the implementation of established policies and procedures,
- Monitoring and reviewing the Company's internal audit function, and
- Maintaining a close relationship with the Company's external auditor and reviewing the effectiveness of the external audit process

As part of its activities, the Audit Committee also reviews and approves key regulatory filings prior to their issue to Ofgem

The Chairman of the Audit Committee reports to the Board of Directors following each committee meeting on the main areas and subjects the Committee has reviewed such as risk management, internal control, internal audit reports and any issues arising from its review of the financial statements

The Board considers that the membership of the Audit Committee as a whole has sufficient recent and relevant financial experience to discharge its functions. The Committee met three times during the year

Southern Gas Networks plc

Safety, Health and Environmental Advisory Committee

The current members of the Safety, Health and Environmental Advisory Committee are James McPhillimy (Committee Chairman), Stephen Dowd, Sebastien Sherman, John Morea (Chief Executive Officer) and Gary Barnes (Director of Corporate Services)

The principal responsibilities of the Safety, Health and Environmental Advisory Committee are as follows -

- Ensuring that the health and safety policy statement and environmental policy statement remain fit for purpose and are being adhered to,
- Reviewing and monitoring the safety, health and environmental strategy and action plan, which shall be designed to eliminate, reduce or otherwise control personal and process related data,
- Reviewing and monitoring the safety, health and environmental compliance and assurance plan (and liaising with the internal auditors in relation thereto),
- Setting health and safety, and environmental targets to improve the Group's performance,
- Monitoring health and safety and environmental performance against planned targets and identified key improvement areas by means of appropriate leading and lagging key performance indicators, and
- Encouraging greater awareness of the importance of health, safety and the environment and higher achievement in performance in these areas

The Chairman of the Safety, Health and Advisory Committee reports to the Board of Directors following each committee meeting on the main areas and subjects the Committee has reviewed. Three meetings were held during the year.

People and Reward Committee

The current members of the People and Reward Committee are Stephen Dowd (Committee Chairman), John McManus (who was appointed as a Committee member on 27 March 2012, succeeding Michael Rolland) and James McPhillimy.

The principal responsibilities of the People and Reward Committee are as follows -

- To determine and agree with the Board of Directors the Group's framework or broad policy for executive and senior management remuneration. The Committee has delegated authority for setting the People and Reward of the CEO, CFO and their direct reports, and
- To review the ongoing appropriateness and relevance of the remuneration policy.

The Chairman of the People and Reward Committee reports to the Board of Directors following each Committee meeting on the remuneration matters which the Committee has reviewed. Four meetings were held during the year.

Board and Committee Performance Evaluations

During the year, the Board has undertaken a comprehensive evaluation of its own performance and that of its three Committees and individual Directors. This was conducted internally using detailed questionnaires which the Chairman then discussed with each Director and the Company Secretary. The Board has considered and discussed the outcomes of the evaluations and is satisfied that it is operating well and focused on the correct strategic issues. The Directors continue to review the Board's performance and that of its three Committees and individual Directors on an annual basis.

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Attendance at Board and Board Committee meetings

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

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

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

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

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

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

Internal Controls in relation to the Company's financial reporting process

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

Accordingly, the Directors have regard to what controls, in their judgement, are appropriate to the business, to the materiality of the risks inherent in the business, and to relative costs and benefits of implementing specific controls.

Internal control is maintained through an organisation structure with clearly defined responsibilities, authority levels and lines of reporting, the appointment of suitably qualified staff in specialised business areas, and continuing investment in high quality information systems. These methods of control are subject to periodic review as to their implementation and continued suitability.

There were no changes in the Company's internal controls over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Internal audit

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

Southern Gas Networks plc

Directors' and Senior Executives' Biographies and Responsibilities

Gregor Alexander, Chairman

Gregor joined the Board of the Company at its inception and was appointed Chairman in July 2011. He is Finance Director of SSE plc and previously worked with the accountancy firm Arthur Andersen. He is a member of the Audit Committee.

Stephen Dowd, Director

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

Robert McDonald, Director

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

James McPhillimy, Director

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

Sebastien Sherman, Director

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

Olivia Steedman, Director

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

John McManus

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

Natalie Bruce

Natalie is Director of Metering at SSE plc and over the past five years has overseen the transformation to nationwide coverage in preparation for Smart Meter deployment. In her previous position, Natalie was Customer Service Operations Manager responsible for SSE Customer Service Centres.

John Morea, Chief Executive Officer

John joined the Company in May 2005 from SSE plc. He has over 20 years experience within the utilities industry. John is a companion of the Institute of Gas Engineers and Managers, a member of the Institute of Engineering and Technology and holds an MBA.

Chris Brook, Chief Financial Officer

Chris joined the Company in September 2008. Chris was previously Finance Director of United Utilities Water, the regulated water business, before joining the Company. Chris is a Chartered Accountant having trained and qualified with Touche Ross.

Nicola Shand, Company Secretary

Nicola was appointed Company Secretary in July 2011. She is also the Group's Commercial Solicitor.

Southern Gas Networks plc

Statement of Directors' responsibilities

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether applicable accounting standards have been followed, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business

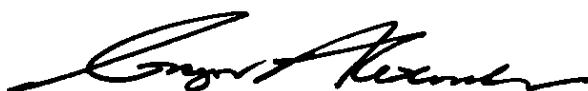
The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time, the financial position of the Company and to enable them to ensure that the financial statements comply with the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

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

The Directors confirm to the best of their knowledge that

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

Signed on behalf of the Board of Directors of Southern Gas Networks plc



Gregor Alexander
Chairman

20 July 2012

Southern Gas Networks plc

Independent auditor's report to the members of Southern Gas Networks plc

We have audited the financial statements of Southern Gas Networks plc for the year ended 31 March 2012 which comprise the profit and loss account, the statement of total recognised gains and losses, the balance sheet and the related notes 1 to 25. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 March 2012 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.

Opinion on other matter prescribed by the Companies Act 2006

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

Southern Gas Networks plc

Matters on which we are required to report by exception

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

- adequate accounting records have not been kept, 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



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

Southern Gas Networks plc

Profit and loss account for the year ended 31 March 2012

	Notes	2012 £m	2011 £m
Turnover	1,2	635.8	549.5
Net operating costs	3	(485.4)	(475.4)
Operating profit	3	150.4	74.1
Income from fixed asset investments	12	0.4	0.4
Interest receivable and similar income	6	10.5	1.5
Interest payable and similar charges	7	(133.6)	(117.0)
Profit/(loss) on ordinary activities before taxation	4	27.7	(41.0)
Tax (charge)/credit on profit/(loss) on ordinary activities	8	(3.9)	11.1
Profit/(loss) for the financial year	19	23.8	(29.9)

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

Southern Gas Networks plc

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

	Notes	2012 £m	2011 £m
Profit/(loss) for the financial year	20	23.8	(29.9)
Cash flow hedges (net of deferred tax)	20	(15.8)	1.3
Actuarial (loss)/gain on defined benefit pension scheme	23	(41.4)	25.4
Movement on deferred tax relating to pension scheme	23	8.6	(7.0)
Total recognised losses for the year		(24.8)	(10.2)

Southern Gas Networks plc

Balance sheet as at 31 March 2012

	Notes	2012 £m	2011 £m
Fixed assets			
Intangible assets - goodwill	10	248.0	253.8
Tangible assets	11	2,409.8	2,396.1
Investments	12	0.2	0.2
		2,658.0	2,650.1
Current assets			
Debtors	13	481.1	286.4
		481.1	286.4
Creditors: amounts falling due within one year	14	(264.5)	(216.4)
Net current assets		216.6	70.0
Total assets less current liabilities		2,874.6	2,720.1
Creditors: amounts falling due after more than one year	15	(2,350.2)	(2,197.9)
Provisions for liabilities	17	(240.5)	(245.1)
Deferred income	11	(85.2)	(74.7)
Net assets excluding pension liabilities		198.7	202.4
Defined benefit pension liabilities	23	(50.2)	(29.1)
Net assets including pension liabilities		148.5	173.3
Capital and reserves			
Called up share capital	18	160.2	160.2
Hedge reserve	19	(32.3)	(16.5)
Profit and loss account	19	20.6	29.6
Shareholder's funds	20	148.5	173.3

The financial statements of Southern Gas Networks plc, registered number 05167021 were approved by the Board of Directors on 20 July 2012 and signed on its behalf by


Gregor Alexander
 Chairman


Sebastien Sherman
 Director

Southern Gas Networks plc

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

1 Principal accounting policies

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

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

A summary of the more significant accounting policies, which have been applied consistently in both years, are as follows:

Basis of preparation

These financial statements have been prepared under the historical cost convention except that assets and liabilities were stated at fair value when acquired, and certain derivative financial instruments are also recorded at fair value. The financial statements have been prepared on the going concern basis as set out in the Directors' Report.

Cash flow statement

The Company is a wholly owned subsidiary of Scotia Gas Networks Ltd and the cash flows of the Company are included in the consolidated cash flow statement of Scotia Gas Networks Ltd. Consequently, the Company is exempt under the terms of FRS 1 ("Cash flow statements") from publishing a cash flow statement.

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. Turnover includes an assessment of transportation services supplied to customers between the date of the last meter reading and the year end.

Where revenues received or receivable differ from the amount permitted by regulatory agreements, adjustments will be made to future prices to reflect this over or under recovery.

Replacement expenditure

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

Taxation

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

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

- provision is made for gains on disposal of fixed assets that have been rolled over into replacement assets only where, at the balance sheet date, there is a commitment to dispose of the replacement assets with no likely subsequent rollover or available capital losses,
- provision is made for gains on revalued fixed assets only where there is a commitment to dispose of the revalued assets and the attributable gain can neither be rolled over nor eliminated by capital losses, and

Southern Gas Networks plc

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

- deferred tax assets are recognised only to the extent that the Directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing difference can be deducted

Deferred tax is measured on an undiscounted basis

Intangible assets – goodwill

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

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

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

Fixed asset investments

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

Tangible fixed assets

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

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

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

Freehold buildings	Up to 50 years
Leasehold buildings	Over the shorter of lease term and 50 years
Plant and machinery	
Mains and services	60 to 65 years
Regulating equipment	30 to 50 years
Gas storage	40 years
Motor vehicles and office equipment	3 to 10 years

Site remediation costs are depreciated over the life of the asset.

Grants and contributions

Capital grants and customer contributions in respect of additions to fixed assets are treated as deferred income and released to the profit and loss account over the estimated useful lives of the related assets.

Revenue grants and contributions are credited to the profit and loss account in the year to which they relate. Deferred income in respect of revenue grants and contributions is included within creditors amounts falling due within one year.

Southern Gas Networks plc

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

Finance leases

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

Operating leases

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis. Benefits received and receivable as an incentive to sign an operating lease are similarly spread on a straight-line basis over the lease term, except where the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate is shorter than the full lease term, in which case the shorter period is used.

Pensions

Defined benefit pension scheme

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

The defined benefit scheme is funded, with the assets of the scheme held separately from those of the 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 method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date.

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

Defined contribution pension schemes

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

Provisions

A provision is recognised in the balance sheet when the 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.

Southern Gas Networks plc

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

Financial instruments

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

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

Effective interest method

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

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

Financial assets

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

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

Impairment of financial assets

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

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

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

Derecognising of financial assets

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

Trade debtors

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

Southern Gas Networks plc

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

Cash and cash equivalents

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

Financial liabilities

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

Financial liabilities at FVTPL

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

A financial liability is classified as held for trading if

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

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

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise, or
- the financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the Group is provided internally on that basis, or
- it forms part of a contract containing one or more embedded derivatives, and FRS 26 Financial Instruments Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL

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

Other financial liabilities

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

De-recognition of financial liabilities

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

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

Derivative financial instruments

The Company uses interest rate swaps and foreign exchange forward contracts to hedge interest rate and foreign currency risk arising on debt instruments. On inception of the hedge relationship the Group documents the relationships between the hedged item and the hedging instrument along with the risk management objectives and its strategy for undertaking various transactions. Furthermore, at inception of the hedge and on an ongoing basis the Company documents whether the hedging relationship is highly effective.

Changes in fair value of derivatives that are designated and are effective as hedges of future cash flows are recognised directly in equity within the hedge reserve. Changes in fair value of derivatives that are designated and are effective as fair value hedges are recognised in the profit and loss account but effectively offset changes in fair value of the hedged item.

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

Hedge accounting is discontinued when the hedge instrument expires or is terminated.

Financial assets and financial liabilities are offset where they are settled net as a matter of practice and there is legal right to offset.

2 Segmental reporting

Turnover arises entirely in the United Kingdom and is attributable to the continuing activity of transportation of natural gas and the provision of related services, which the Directors consider represents a single class of business.

3 Operating profit and net operating costs

	2012 £m	2011 £m
Turnover	635.8	549.5
Distribution costs	(487.3)	(477.3)
Profit on disposal of fixed assets	-	0.3
Other operating income	1.9	1.6
Net operating costs	(485.4)	(475.4)
Operating profit	150.4	74.1

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

Southern Gas Networks plc

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

4 Profit/(loss) on ordinary activities before taxation

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

	2012 £m	2011 £m
Auditor's remuneration	0.1	0.1
Goodwill amortisation	5.8	5.7
Depreciation	70.6	67.8
Replacement expenditure	198.4	192.6

Auditor's remuneration comprises £48,500 (2011 £53,000) in respect of statutory and regulatory audit services, £25,000 (2011 £25,000) in respect of other services pursuant to legislation, £44,000 (2011 £12,000) in respect of bond issue assurance work, £14,400 (2011 £nil) in respect of IT consultancy services, £45,000 (2011 £nil) in respect of PCR consulting services and £21,000 (2011 £nil) in respect of tax consultancy services

In addition to the above services, the Company's auditor acted as auditor to the Scotia Gas Networks Pension Scheme, and fees of £9,600 (2011 £9,000) have been charged by the auditor to the Company in respect of these services

5 Employee information and Directors' emoluments

The Company had 978 full time equivalent employees as at 31 March 2012 (2011 1,016). The average monthly number of full time equivalent employees during the year was 1,001 (2011 1,037)

The Directors did not receive any remuneration for their services to the Company during the year, or during the prior year. No retirement benefits are accruing in the year or in the prior year to any Directors under money purchase or defined benefit schemes, in respect of their services to the Company

Staff costs for the Company during the year are as follows

	2012 £m	2011 £m
Staff costs		
Wages and salaries	45.8	43.6
Social security costs	4.3	3.9
Pension costs	13.3	13.9
	63.4	61.4

Southern Gas Networks plc

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

6 Interest receivable and similar income

	2012 £m	2011 £m
Interest receivable on loans to other Group undertakings	2.2	1.4
Net pension credit (see note 23)	1.1	-
Other finance income		
Movements on Financial Derivatives	7.2	0.1
	10.5	1.5

7 Interest payable and similar charges

	2012 £m	2011 £m
Index linked bond interest	35.7	31.4
Other interest payable on bonds	82.7	75.8
Other interest payable	4.5	5.2
Net pension charge (see note 23)	-	0.1
Unwind of discounts in provisions (see note 17)	10.7	4.5
	133.6	117.0

Southern Gas Networks plc

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

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

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

	2012 £m	2011 £m
Current tax		
UK Corporation tax on profits for the period	(0.6)	-
Adjustment in respect of prior period – surrender of tax losses	-	3.0
Total current tax (charge)/credit	(0.6)	3.0
Deferred tax		
Deferred tax (charge)/credit for the year	(14.4)	3.1
Effect of change in tax rate	10.9	8.4
Adjustments in respect of prior years	0.2	(3.4)
Total deferred tax (charge)/credit for the year	(3.3)	8.1
Total tax (charge)/credit on profit/(loss) on ordinary activities	(3.9)	11.1

b) Factors affecting the current tax (charge)/credit for the year

	2012 £m	2011 £m
Profit/(loss) on ordinary activities before tax	27.7	(41.0)
Profit/(loss) on ordinary activities multiplied by standard rate of corporation tax in the UK of 26% (2011: 28%)	(7.2)	11.5
Effects of		
Deferred tax on accelerated capital allowances	4.3	5.0
Deferred tax on unutilised losses	-	(16.1)
Depreciation on non-qualifying assets	(5.9)	(6.3)
Other short term timing differences	5.8	7.8
Expenses not deductible for tax purposes	(1.9)	(1.9)
Utilisation of brought forward losses	4.3	-
Adjustment in respect of prior period – proceeds from sale of tax losses	-	3.0
Current tax (charge)/credit	(0.6)	3.0

The Budget on 21 March 2012 announced an additional 1% reduction in the main rate of corporation tax, giving a rate of 24% (previously 25%) from 1 April 2012. As this rate change was substantively enacted at the balance sheet date, deferred tax has been restated accordingly in these financial statements. This has the effect of reducing the Group's net deferred tax liabilities recognised at 31 March 2012 by £10.9m.

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

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

9 Dividends

	2012 £m	2011 £m
Interim dividends paid £nil per share (2011 32.96 pence)	-	52.8

No final dividends are proposed in respect of the year ended 31 March 2012 (2011 £nil)

10 Intangible fixed assets

	Goodwill £m
Cost	
At 1 April 2011 and at 31 March 2012	287.5
Accumulated amortisation	
At 1 April 2011	33.7
Charge for the year	5.8
At 31 March 2012	39.5
Net book value	
At 31 March 2012	248.0
At 31 March 2011	253.8

The goodwill, which arose on the acquisition of the business by the Company, is being amortised on a straight line basis over 50 years. This is the period over which the Directors estimate that the value of the underlying business acquired is expected to exceed the value of the underlying assets.

A review for impairment of goodwill is carried out at the end of each financial year. No impairment loss has been recorded in either the current year or the prior year.

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

11 Tangible fixed assets

Group	Short leasehold properties £m	Freehold Properties £m	Plant and machinery £m	Motor vehicles and office equipment £m	Total £m
Cost					
At 1 April 2011	0.5	37.0	2,602.0	97.5	2,737.0
Additions	-	2.0	68.2	14.1	84.3
At 31 March 2012	0.5	39.0	2,670.2	111.6	2,821.3
Depreciation					
At 1 April 2011	0.1	5.0	301.6	34.2	340.9
Charge for the year	-	1.7	57.4	11.5	70.6
At 31 March 2012	0.1	6.7	359.0	45.7	411.5
At 31 March 2012	0.4	32.3	2,311.2	65.9	2,409.8
At 31 March 2011	0.4	32.0	2,300.4	63.3	2,396.1

The Company has received customer contributions relating to plant and machinery and meters. In accordance with the Company's accounting policy the assets are capitalised within fixed assets and the contributions received are recognised as deferred income in the balance sheet. The deferred income is released to the profit and loss account over the estimated lives of the related assets. The amount deferred under this policy is as follows:

	2012 £m	2011 £m
Deferred income		
Customer contributions brought forward	74.7	64.7
Customer contributions received in year	12.4	11.6
Amortisation in year	(1.9)	(1.6)
	85.2	74.7

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

12 Fixed asset investments

	2012 £m	2011 £m
Other investments		
Cost and net book value	0.2	0.2

Fixed asset investments relate to an investment in Xoserve Limited, which provides transportation transactional services on behalf of all the major gas network transportation companies. The Company holds 16.1% (2011: 16.1%) of the ordinary shares of Xoserve Limited.

During the year the Company received dividends of £442,000 (2011: £419,000) in relation to this investment.

13 Debtors

	2012 £m	2011 £m
Amounts falling due within one year		
Trade debtors	34.0	28.0
Amounts owed by Group undertakings	435.1	255.2
Prepayments and accrued income	3.9	2.2
Derivative financial instruments	8.1	1.0
	481.1	286.4

Trade debtors are stated net of bad debt provisions of £0.3m (2011: £0.2) and credit note provisions of £1.2m (2011: £0.6m).

Within amounts owed by Group undertakings are loans amounting to £433.5m (2011: £255.2m) which incur 1.5% (2011: 1.5%) interest and are repayable on demand.

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

14 Creditors: amounts falling due within one year

	2012 £m	2011 £m
Bank loans	2.7	4.4
Trade creditors	35.4	22.9
Amounts owed to Group undertakings	81.3	54.6
Other taxation and social security	14.7	14.7
Other creditors	0.8	1.3
Accrued interest	36.4	29.2
Other accruals	49.5	51.7
Deferred income	8.8	12.5
Derivative financial instruments	34.9	25.1
	264.5	216.4

Amounts owed to Group undertakings comprise of trading balances

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

15 Creditors: amounts falling due after more than one year

	2012 £m	2011 £m
Bonds:		
Fixed rate and index linked:		
£300m 5 125% fixed rate due 2018	298.2	298 0
£215m 4 875% fixed rate due 2020	214.5	214 3
£300m 4 875% fixed rate due 2023	297.1	-
£150m 2 066% index linked due 2025	186.0	176 8
£15m 2 580% index linked due 2028	16.8	16 0
£375m 4 875% fixed rate due 2029	373.6	373 5
£250m 2 013% index linked due 2035	310.0	294 6
£225m 6 38% fixed rate due 2040	223.5	223 5
	1,919.7	1,596 7
Floating rates:		
£233m floating rate note due 2015	232.8	232 7
£100m floating rate note due 2015	99.9	99 8
£50m floating rate note due 2018	50.0	50 0
£50m floating rate note due 2019	50.0	50 0
	432.7	432 5
Total bonds	2,352.4	2,029 2
Revolving credit facility drawn	(2.2)	168 7
	2,350.2	2,197 9

Maturity of borrowings

	2012 £m	2011 £m
Due within one year	-	-
Between one and five years	333.0	501 2
After five years	2,017.2	1,696 7
	2,350.2	2,197 9

Matunty of borrowings

The total revolving credit facility is £200 0 million and expires in November 2016

The above borrowings are stated after the deduction of unamortised issue costs of £11 6m (2011 £8 5 million) These costs, together with the interest expense, are allocated to the profit and loss

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

account over the term of the borrowings Interest is calculated using the effective interest rate method

Certain interest costs in respect of index linked bonds are not payable until the principal amount of the bond is repaid and are included within the carrying value of the borrowings stated above The amount included in the carrying value of the borrowings at 31 March 2012 is £98.8m (2011 £73.4m)

16 Financial Instruments

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

The Company is a wholly owned subsidiary of Scotia Gas Networks Limited and accordingly is exempt from the disclosures required under FRS 29 (Financial Instruments Disclosure) as these are detailed in the annual report of Scotia Gas Networks Limited

17 Provisions for liabilities

Group	Onerous financial instruments £m	Environmental £m	Deferred tax £m	Other Provisions £m	Total £m
At 1 April 2011	112.7	14.1	113.8	4.5	245.1
Utilised during the year	(14.4)	(0.3)	-	(0.4)	(15.1)
Arising during the year	-	0.6	-	0.9	1.5
Net movement in deferred tax	-	-	(1.7)	-	(1.7)
Amortisation of discount	9.8	0.9	-	-	10.7
At 31 March 2012	108.1	15.3	112.1	5.0	240.5

Onerous financial instruments

The onerous financial instruments provision relates to interest rate swap contracts that the Company holds The provision recorded at each balance sheet date represents the aggregate fair value of the swap contracts held The provision will be utilised as cash settlement payments are made over the life of the swaps over the next thirteen years

Environmental provision

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 nineteen years

Southern Gas Networks plc

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

Deferred tax

The net movement on the deferred tax provision has decreased as a result of a reduction in tax rates to 24%, offset by other movements in the year, of which £0.2m is recorded as a credit to the profit and loss account and £0.7m is recorded as a credit to the statement of total recognised gains and losses

Deferred taxation recognised in the financial statements (excluding deferred tax recognised in respect of pension liabilities (see note 23)) is as follows

	2012 £m	2011 £m
Accelerated capital allowances	(154.9)	(163.2)
Deferred tax asset on losses	36.2	43.1
Deferred tax on cash flow hedge	8.4	6.5
Other timing differences	(1.8)	(0.2)
	(112.1)	(113.8)

The movement in provision for deferred tax is as follows

	2012 £m	2011 £m
At 1 April	(113.8)	(128.6)
Charged to profit and loss account	(0.2)	16.0
Charged to statement of recognised gains and losses	1.9	(1.2)
At 31 March	(112.1)	(113.8)

The Company has no unrecognised deferred tax assets or liabilities. In accordance with FRS 19 ("Deferred tax"), deferred tax has been measured based upon a corporation tax rate of 24% (2011 26%), being the tax rate substantively enacted at the balance sheet date

Other provisions

Other provisions represent the cost of executing certain restructuring plans and a provision for other legal and constructive obligations held by the Company. The provision is expected to be utilised over the next fifteen years.

18 Called up share capital

At 31 March 2011 and 31 March 2012	Number	£m
Allotted, called up and fully paid		
Ordinary shares of £1 each	160,174,772	160.2

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

19 Reserves

	Hedge reserve £m	Profit and loss account £m
At 1 April 2011	(16.5)	29.6
Profit for the financial year	-	23.8
Movement on cash flow hedge	(17.7)	-
Deferred tax on cash flow hedge	1.9	-
Actuarial loss on defined benefit pension scheme (net of related tax)	-	(32.8)
At 31 March 2012	(32.3)	20.6

20 Reconciliation of movements in shareholder's funds

	2012 £m	2011 £m
Profit /(loss) for the financial year	23.8	(29.9)
Dividends	-	(52.8)
Cash flow hedge (net of related tax)	(15.8)	1.3
Actuarial (loss)/gain on defined benefit pension scheme (net of related tax)	(32.8)	18.4
Net decrease in shareholder's funds	(24.8)	(63.0)
Opening shareholder's funds	173.3	236.3
Closing shareholder's funds	148.5	173.3

21 Operating lease commitments

The Company has lease agreements in respect of properties for which the payments extend over a number of years

	2012 £m	2011 £m
Annual commitments under non-cancellable operating leases		
After five years	0.2	0.2

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

22 Capital commitments

Capital projects contracted for by the Company but not provided in the financial statements amounted to £4.4m at 31 March 2012 (2011: £3.4m)

23 Pension commitments

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

(a) Defined benefit scheme

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

The latest full actuarial valuation was carried out as at 31 March 2009. In accordance with FRS 17, a limited actuarial review has been carried out by Hymans Robertson at 31 March 2012 using the projected unit method.

The following financial assumptions have been used:

	As at 31 March 2012	As at 31 March 2011	As at 31 March 2010	As at 31 March 2009
Discount rate	4.6% p.a.	5.5% p.a.	5.5% p.a.	6.7% p.a.
Inflation assumption	3.2% p.a.	3.5% p.a.	3.7% p.a.	3.0% p.a.
Rate of increase of salaries	4.7% p.a.	5.0% p.a.	5.2% p.a.	4.5% p.a.
Rate of increase of pensions payment	3.2% p.a.	3.5% p.a.	3.7% p.a.	3.0% p.a.

The assumptions relating to longevity underlying the pension liabilities reflect the characteristics of the Scheme membership ('VitaCurves') for base mortality with an allowance for further improvements in life expectancy in line with the medium cohort adjustments subject to a 1.5% p.a. underpin in the longevity assumption. The assumed life expectancy in years for a member once they reach age 65 is as follows:

As at 31 March	2012		2011		2010	
	Male	Female	Male	Female	Male	Female
Member currently aged 65	21	24	21	23	21	23
Member currently aged 45	25	28	24	27	24	27

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

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

31 March	2012		2011		2010		2009		2008	
	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m
Equities	7.0%	155.0	7.8%	167.7	8.0%	185.0	7.7%	116.8	8.0%	137.1
Government bonds	3.3%	99.8	4.3%	59.5	4.5%	37.9	4.2%	38.2	4.5%	41.8
Corporate bonds	4.6%	99.8	5.5%	80.7	5.5%	30.4	6.7%	18.1	6.9%	15.1
Property	5.0%	24.1	5.3%	21.8	5.5%	12.1	5.2%	7.4	5.5%	13.1
Cash	1.9%	4.8	1.5%	5.9	1.1%	16.0	2.2%	10.4	5.8%	8.5
Total market value of assets		383.5		335.6		281.4		190.9		215.6
Actuarial value of liabilities		(449.5)		(374.9)		(371.1)		(221.3)		(199.7)
(Deficit)/surplus in scheme		(66.0)		(39.3)		(89.7)		(30.4)		15.9
Related deferred tax asset/(liability)		15.8		10.2		25.1		8.5		(4.4)
Net pension (liability)/asset		(50.2)		(29.1)		(64.6)		(21.9)		11.5

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

Movement in fair value of scheme assets

	2012 £m	2011 £m
At 1 April	335.6	281.4
Expected return on scheme assets	21.9	20.6
Contributions from scheme members	1.0	1.0
Contributions from the Company	26.6	38.7
Actuarial gains/(loss)	3.9	(2.0)
Benefits paid	(5.5)	(4.1)
As at 31 March	383.5	335.6

Southern Gas Networks plc

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

Movement in fair value of scheme liabilities

	2012 £m	2011 £m
At 1 April	(374.9)	(371.1)
Service cost	(13.0)	(13.6)
Interest cost	(20.8)	(20.7)
Contributions from scheme members	(1.0)	(1.0)
Actuarial (losses)/gains	(45.3)	27.4
Benefits paid	5.5	4.1
At 31 March	(449.6)	(374.9)

The Group's contribution rate during the year was 37.3% of pensionable earnings. Additionally, the Group made special pension contributions to repair the deficit amounting to £23.5m, of which the Company's share was approximately £14.1m. The expected contributions to be made in the year to 31 March 2013 are 37.3% of pensionable salary.

The actual return on scheme assets was £25.8m (2011: gain of £18.6m).

The cumulative amount of actuarial losses recognised in the statement of total recognised gains and losses since the adoption of FRS 17 is £80.5m (2011: £47.7m).

Analysis of the amounts recognised in the profit and loss account

	2012 £m	2011 £m
Amount charged to operating profit:		
Current service cost	(13.0)	(13.6)
Analysis of the amount credited to finance charge:		
Expected return on pension scheme assets	21.9	20.6
Interest on pension scheme liabilities	(20.8)	(20.7)
Net finance credit/(charge) (see note 6 and 7)	1.1	(0.1)
Net charge to the profit and loss account	(11.9)	(13.7)

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

	2012 £m	2011 £m
Actual return less expected return on pension scheme assets	3.9	(2.0)
Actuarial (losses)/gains on obligation	(45.3)	27.4
Deferred tax	8.6	(7.0)
Actuarial (loss)/gain recognised in STRGL	(32.8)	18.4

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

History of experience gains and losses

	2012	2011	2010	2009	2008
Fair value of plan assets	£383.5m	£335.6m	£281.4m	£190.9m	£215.6m
Present value of defined benefit obligation	(£449.5m)	(£374.9m)	(£371.1m)	(£221.3m)	(£199.7m)
(Deficit)/surplus	(£66.0m)	(£39.3m)	(£89.7m)	(£30.4m)	£15.9m
Experience adjustments on scheme assets	£3.9m	(£2.0m)	£58.9m	(£49.7m)	(£21.5m)
- Percentage of scheme assets at year end	1.0%	(0.6%)	20.9%	(26.0%)	(10.0%)
Experience adjustments on scheme liabilities	£7.8m	£9.4	(£12.4m)	-	-
- Percentage of the present value of scheme liabilities at year end	1.7%	2.5%	(3.3%)	-	-
Total actuarial (losses)/gains on obligation	(£45.3m)	£27.4m	(£128.3m)	£4.9m	£45.5m
- Percentage of the present value of scheme liabilities at year end	(10.1%)	7.3%	(34.6%)	2.2%	22.2%

Movement in deficit during the year

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Deficit in scheme at start of year	(39.3)	(89.7)	(30.4)	-	(40.7)
Movement in year					
- Current service costs	(13.0)	(13.6)	(8.5)	(8.1)	(11.0)
- Contributions	26.6	38.7	20.7	20.7	20.5
- Other finance income	1.1	(0.1)	(2.1)	1.8	1.6
- Actuarial(loss)/gain	(41.4)	25.4	(69.4)	(44.8)	45.5
Restriction of recognised surplus	-	-	-	-	(15.9)
Deficit in scheme at end of year	(66.0)	(39.3)	(89.7)	(30.4)	-

(b) Defined contribution schemes

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

	2012 £m	2011 £m
Amount charged in respect of defined contribution schemes	0.3	0.3

Southern Gas Networks plc

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

24 Related parties

In accordance with FRS8 'Related party disclosures' the Company is exempt from disclosing transactions with entities that are part of the Group qualifying as related parties, as it is a wholly owned subsidiary of a parent, which prepares consolidated accounts which are publicly available

The Company's parent, Scotia Gas Networks Limited is owned by a consortium consisting of SSE plc (50%), Borealis Infrastructure Europe (UK) Limited (25%), which is indirectly wholly owned by OMERS Administration Corporation, and OTPPB Investments (UK) Limited (25%), which is owned by Ontario Teachers' Pension Plan Board. The transactions with the shareholders of the parent are set out below

	2012 £m	2011 £m
Other amounts owed to shareholders:		
SSE plc	4.0	8.4

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

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

	2012 £m	2011 £m
Sales of goods and services	109.3	89.9
Purchase of goods and services	(44.7)	(36.2)
Sale of tax losses	-	3.0

Sales of goods and services to SSE primarily represent gas transportation services. At 31 March 2012 an amount of £9.9m (2011: £8.3m) was owed by SSE in relation to these services and is included within trade debtors

SSE provides services to the Company in the form of a management services agreement for corporate services. The Company also purchases certain items such as consumables stock, shrinkage gas and public liability insurance from SSE. Included within purchases of goods and services are direct costs of £nil (2011: £0.4m) recharged by SSE which have been capitalised in the year

During the year, the Company did not surrender any tax losses of to SSE (2011: £12.2m relating to the year ended 31 March 2009 for an aggregate cash consideration of £3.0m)

25 Parent Company

The Company is a wholly owned subsidiary of Scotia Gas Networks Limited, a Company registered in England and Wales

Scotia Gas Networks Limited is owned by a consortium consisting of SSE plc (50%), Borealis Infrastructure Europe (UK) Limited (25%) which is indirectly wholly owned by OMERS Administration Corporation and OTPPB Investments (UK) Limited (25%), which is owned by Ontario Teachers' Pension Plan Board. It is the opinion of the Directors that the parent Company, Scotia Gas Networks Limited, has no single controlling party as that Company is controlled jointly by the consortium

Scotia Gas Networks Limited publishes consolidated financial statements and is the largest and smallest Group which consolidate the financial statements of the Company. Copies of the financial statements of Scotia Gas Networks Limited may be obtained from the Company Secretary, St Lawrence House, Station Approach, Horley, Surrey, RH6 9HJ