

Scottish Hydro Electric Power Distribution plc

Directors Report and Financial Statements

Year ended 31 March 2023

Registered No.: SC213460

Scottish Hydro Electric Power Distribution plc

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Directors and Other Information

Directors

Alistair Phillips-Davies (Non-Executive Director, Chairman) (Appointed 03/04/2023)
Chris Burchell
Dinesh Manuelpillai (Appointed 30/06/2023)
Eliane Algaard
Mark Rough
Katherine Marshall (Non-Executive Director)
Sam Peacock (Non-Executive Director) (Appointed 01/05/2023)
David Rutherford (Independent Non-Executive Director)
Maxine Frerk (Independent Non-Executive Director) (Appointed 01/05/2023)

Gregor Alexander (Non-Executive Director, Chairman) (Resigned 03/04/2023)
Rob McDonald (Resigned 03/04/2023)
Sandy MacTaggart (Resigned 03/04/2023)
Maz Alkirwi (Resigned 03/04/2023)
Rachel McEwen (Non-Executive Director) (Resigned 01/05/2023)
Gary Steel (Independent Non-Executive Director) (Resigned 01/05/2023)

Registered office

Inveralmond House
200 Dunkeld Road
Perth
PH1 3AQ

Secretary

Helen McCombe (Appointed 26/10/2022)
Mark McLaughlin (Resigned 26/10/2022)

Auditor

Ernst & Young LLP
G1 5 George Square
Glasgow
G2 1DY

Registered number

SC213460

Scottish Hydro Electric Power Distribution plc

Strategic Report

The Strategic Report sets out the main trends and factors underlying the development and performance of Scottish Hydro Electric Power Distribution plc (the “Company”) during the year ended 31 March 2023, as well as those matters which are likely to affect its future development and performance.

The business, its objectives and strategy

The Company is a wholly owned subsidiary of SSE plc (the “Group”). The Company’s immediate parent for the year ended 31 March 2023 was Scottish and Southern Energy Power Distribution Limited (SSEPD) which is branded as Scottish and Southern Electricity Networks (SSEN). SSEPD ceased control of the Company on 3 April 2023 and on the same date SSEN Distribution Limited assumed control as immediate parent of the Company. Included within the SSEN Distribution group is sister company Southern Electric Power Distribution plc (SEPD). The Company distributes electricity to over 0.7 million (2022: 0.7 million) customers in the north of Scotland. It currently has around 50,000 (2022: 50,000) kilometres of electricity mains on commission. The Company also provides electricity connections within the Company’s licensed area and owns and operates a number of out of area electricity networks in the rest of Scotland.

The Company is the subject of incentive-based regulation by the industry regulator, the Office of Gas and Electricity Markets (Ofgem), which sets the prices that can be charged for the use of the electricity network, the allowed capital and operating expenditure, within a framework known as the price control. In broad terms, Ofgem seeks to strike the right balance between attracting investment in electricity networks, encouraging companies to operate the networks as efficiently as possible and ensuring that prices for customers are no higher than they need to be. Ofgem also places specific incentives on companies to improve their efficiency and quality of service. The RIIO-ED1 (Revenue = Incentives + Innovation + Outputs) price control period ran for eight years from 1 April 2015 until 31 March 2023 and looking forward, the Company now focuses on executing their RIIO-ED2 business plan on commencement of the new RIIO-ED2 price control, which lasts from 1 April 2023 to 31 March 2028.

While the Group’s original Net Zero Action Plan (NZAP) assumed a minority stake sale in the Company, the Group’s updated NZAP Plus plan now reflects the decision that retaining 100% of the Company is the right strategy at this time.

The Company’s strategy and main objectives are to:

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

Business performance overview

The key performance indicators of the Company and the related performance during the year to 31 March 2023 were as follows:

Financial / Operational	2023	2022
Reported Operating Profit - £m	97.5	105.9
Exceptional impairment costs - £m	-	20.7
Derivative re-measurements - £m	1.2	0.1
Adjusted Operating Profit - £m	98.7	126.7
Capital expenditure - £m	194.0	163.2
Regulated asset value (RAV) - £m	1,556.9	1,340.9

Scottish Hydro Electric Power Distribution plc

Strategic Report *(continued)*

Business performance overview *(continued)*

Non-Financial / Management	2023	2022
Customer Minutes Lost - number per customer	59	57
Customer Interruptions - number per 100 customers	60	56
Electricity distributed (TWh)	6.7	7.1

The performance of the Company is considered on adjusted operating profit which excludes non-recurring exceptional impairment costs and re-measurements arising from operating derivatives.

The Company was exposed to market risk on commodity derivatives in the year, associated with fluctuations in the market price of oil which can cause volatility on revaluation. The Company's adjusted operating profit measure excludes this mark-to-market movement as it is not relevant in assessing underlying performance. The commodity derivative fully expired in December 2022.

The adjusted operating profit has decreased by 22.1% to £98.7m in the year. This is mainly due to lower than expected Distribution Use of System 'DUoS' volumes in 2022/23, associated with the cost of living crisis in the UK. This more than offset a reduction in fault costs, given the impact of severe weather on the network during 2021/22.

If in any year, Distribution Network Operator (DNO) companies' revenue is greater (over recovery) or lower (under recovery) than is allowed under the RIIO-ED1 price control, the difference is carried forward and the subsequent prices the companies may charge are adjusted. Under the regulatory framework, distribution tariffs are set two years in advance which means the over/under recovery built into tariffs is a forecast and will differ from the actual outturn. Any difference is reflected in future tariff years meaning any difference in the 2022/23 forecast compared to actual will be fully unwound through revenue by 2025/26. The phasing of changes in tariffs and volumes between reporting periods has meant an over-recovery of £8.5m in 2021/22 was replaced with a £8.0m under-recovery in 2022/23.

Volume of electricity distributed

The total volume of electricity distributed by the Company during 2022/23 was 6.7TWh, compared with 7.1TWh in 2021/22. Under RIIO-ED1, the volume of electricity distributed does not affect the Company's overall allowed revenue. This only has an impact on the timing of revenue collection as any over or under recovery which arises as a result will not be fully unwound until 2025/26, as described above.

Delivering for customers and investors under the incentive based framework

The year ended 31 March 2023 marked the final year of the RIIO-ED1 price control, and the Company continues to deliver significant changes to its operations, processes and standards to ensure the needs of its customers remain at the forefront of decision making throughout RIIO-ED2. It aims to be as efficient and effective as possible to earn returns that are fair to customers and shareholders alike, focusing on four key areas:

- Good performance in relation to incentives available within RIIO-ED1 and RIIO-ED2;
- Efficient delivery of capital investment;
- Focused delivery of regulatory outputs; and
- Maintaining a leadership position in innovation.

Targeting performance in interruption incentives

Incentive performance remains a priority as the Company strives to deliver reliable network performance while supporting a positive customer experience. Under the RIIO regulatory regime, and in particular the Interruptions Incentive Scheme (IIS), the Company is incentivised on its performance against the loss of electricity supply through the recording of Customer Interruptions (CI) and Customer Minutes Lost (CML) which includes both planned and unplanned supply interruptions. These incentives will typically be collected two years after they are earned.

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Strategic Report *(continued)*

Targeting performance in interruption incentives *(continued)*

During the year, the Company's Customer Minutes Lost (CML) increased from 57 to 59 minutes per customer and Customer Interruptions (CI) increased from 56 to 60 per 100 customers. The Company continues to outperform the pre-determined targets set by Ofgem. Whilst performance in response to unplanned network faults improved in comparison to 2021/22, reflecting investment in automation and operational response, a rise in planned interruptions to facilitate new connections has impacted IIS performance.

The Company incurred a penalty award of £0.6m in 2022/23, which is a decrease on the £1.2m incentive award achieved in 2021/22. This is in light of two extreme weather events affecting the Company in the 2022/23, an ice storm in Shetland in December 2022 and Storm Otto in February 2023. While the events impacted the incentive; power restoration efforts during both weather events were swift and effective as reflected in a motion in the Scottish Parliament praising the Company's 'exceptional response' to Storm Otto, citing improvements in restoration, communications and customer service.

Delivering for customers and stakeholders

In 2022/23, the Company's total incentive reward against the Customer Satisfaction Incentive was £2.7m, up from £2.3m in the previous year, continuing the upward trend which has been supported by a comprehensive improvement plan for each Broad Measure category. The Company is addressing network resilience through its capital and operational investment plans, including a Climate Resilience Strategy published as part of the RIIO-ED2 business plan.

The Company continued to embed learnings from its Storm Arwen review and action plan, rolling out new processes and procedures in the Shetland ice storm in December 2022 and Storm Otto in February 2023. An improvement in storm responses, and consistent 'above and beyond' levels of service, received plaudits from the government, customers and other stakeholders.

In 2022/23 the Company, together with its sister company SEPD, received its highest ever league table position in the Stakeholder Engagement and Customer Vulnerability (SECV) standings, resulting in an estimated revenue of £1.5m collectively. Support for customers in vulnerable situations also increased with registrations to SSEN's Priority Services Register rising by 11% compared to the previous financial year through targeted communications and partnerships. In addition, over 14,500 UK households were supported by fuel poverty and energy efficiency measures, an increase of almost 70% on 2021/22.

In March 2023, the Company, alongside sister company SEPD, published its Fair Energy Future report and in doing so became the first Distribution Network Operator (DNO) to publish a consumer-led just transition action plan aimed at securing a fair and inclusive net zero transition for all.

Driving value from connections

The customer-focused improvements the Company has implemented in its connections business continues to deliver consistent high performance, reflected by an award of £1.3m under the Average Time to Connect (TTC) Incentive for 2022/23. This is an increase on performance last year where the Company received a reward of £1.0m.

Ofgem announced its decision not to penalise the Company under the penalty only Incentive on Connections Engagement (ICE). This is the seventh consecutive year the Company has avoided a penalty since its introduction at the beginning of the RIIO-ED1 price control period.

In line with the RIIO-ED1 regulatory settlement, incentive targets have become harder to achieve in the second half of the price control.

Operational delivery

Key to the successful delivery against any regulatory price control is efficient and focused capital investment, upgrading and expanding the infrastructure critical to support the net zero transition. In 2022/23, the Company continued its major capital investment programme, delivering significant improvements for customers and increasing Regulated Asset Value (RAV). During 2022/23, the Company's RAV additions in the electricity distribution network was £166.2m, bringing the total RAV additions since the beginning of the RIIO-ED1 price control to over £1.0bn.

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Strategic Report *(continued)*

Operational delivery *(continued)*

In December 2022, Ofgem published its Final Determinations for the RIIO-ED2 price control outlining its response to the Company's Business Plan 'Powering Communities to Net Zero'. The Company accepted Ofgem's Final Determination in March and will continue to work closely with the regulator to ensure the price control has the agility and flexibility required to keep pace with net zero requirements. The price control began in April 2023 and will run until March 2028.

As part of its 'flexibility first' approach to network investment, the Company continues to secure flexible energy service contracts with the objective of powering an increasing amount of homes. This will increasingly play a vital role in supporting the delivery of a smarter electricity grid and a cost-effective transition to net zero.

Achieving the UK's net zero ambitions will require extensive electrification of heat and transport and it is crucial that the local electricity distribution networks act as an enabler not a constraint to this significant change. The Company strongly supports a mechanism for strategic investment in flexible solutions or network reinforcement to enable a cost-effective transition to net zero for the households, businesses and communities it serves.

Major Capital Investment

The Company delivered against a vast range of projects in the north network regions during the final year of RIIO-ED1. The new price control period will see the acceleration of the Company's major capital investment programme across its license area, delivering significant improvements for customers and supporting future earnings through RAV growth.

In the final year of RIIO-ED1 the Company invested £178m in the network across a broad range of projects with additional reinforcement spend needed following storm damage in FY22. The Company delivered investment of £10m to upgrade infrastructure at Aultbea-Ullapool and £5m on Islay to maintain and enhance network reliability to these island communities. Both projects are underway and will be complete by 2023/24.

Global events

The UK energy market has seen extreme volatility throughout the 2022/2023 period, with gas and power prices significantly above seasonal norms. This market volatility has resulted in difficulties for smaller energy suppliers. Ofgem has provisions in place to ensure continuity of supply to customers of failed suppliers through the Supplier of Last Resort (SoLR) process. As a DNO, the Company is required to make Last Resort Supplier Payments (LRSP) to Suppliers of Last Resort to cover the cost of acquiring customers from failed suppliers. These additional costs will be recovered through tariff charges.

In response to the security of supply concerns across GB and the possibility of emergency disconnections, the Company alongside SEPD was the first DNO to develop an emergency planning portal for customers and conducted engagement with over 2,500 stakeholders to help ensure preparedness and community resilience.

Growth Opportunities for RIIO – ED2

The Company's RIIO-ED2 Business Plan, published under the brand SSEN Distribution in conjunction with sister company SEPD, is a core component of the Group's NZAP Plus. The RIIO-ED2 regulatory price control is an important step on the road to net zero and throughout the past year the Company has worked to reach a settlement that balances the needs of customers and the environment.

Publication of Final Determinations on the Company's RIIO-ED2 business plan was on the back of the first draft submission in June 2022 and after discussion with Ofgem, an agreed final determination on the RIIO-ED2 period was reached. This quantified the outputs that the Company is committed to deliver and the funding (allowances) available to deliver those outputs.

The Final Determination from Ofgem provides SSEN Distribution with a proposed total base expenditure of £1.2bn, an uplift of over 17% on the equivalent period in RIIO-ED1, including potential additional investment opportunities of up to £0.3bn over the period through uncertainty mechanisms and reopeners.

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Strategic Report *(continued)*

Growth Opportunities for RIIO – ED2 *(continued)*

Titled 'Powering Communities to Net Zero' the RIIO-ED2 business plan sets out six clear stakeholder-led goals that the Company will deliver for customers and communities, alongside its sister company, SEPD, by 2028:

- Reduce the frequency and duration of unplanned power interruptions by 20%;
- Create a foundation for net zero by investing £1bn in strategic resilience across its networks;
- Achieve a customer satisfaction score of 9.2 or more (out of 10) in every customer contact area;
- Support 200,000 customers in vulnerable situations with targeted fuel poverty, personal resilience and energy efficiency measures;
- Facilitate the connection of an additional 1.3 million electric vehicles and 800,000 heat pumps; and
- Reduce its business carbon footprint by at least 35%, aligned to a 1.5c science-based target.

The business plan was stakeholder-led, with more than 25,000 people having a say in its development. It opens the way for significant investment in local network infrastructure that will accelerate decarbonisation of streets and homes; improve reliability and services for customers; and build the smart, flexible network of the future. While the original plan contained 64 outputs, the Final Determination reduced the funding in the core plan by around 12%. This required a recalibration of what the business can deliver and further extensive engagement with affected stakeholders on the likely impacts. This follow-up engagement included detail of Uncertainty Mechanisms (UMs) that will enable the Company to further invest in the network to facilitate growing net zero ambitions.

Accelerating Connections

With the transition to net zero gathering pace, the Company is seeing a significant rise in the uptake of low-carbon technologies, particularly EV charge points, heat pumps, and battery storage. The Company has seen a 75% uplift in the number of electric vehicle charge points connected compared to last year.

The Company's network is experiencing rapid growth in both generation and demand requests, with significant large load requests coming from data centres and contracted batteries doubling over the past year.

Empowering Local Investment and Growing Flexibility

The Company's current RIIO-ED2 business plan for 2023 to 2028 sets out the flexibility and network investment required to accelerate net zero and therefore is aligned to the opportunities arising from a 1.5°C scenario.

The Company is also increasing tendering its flexibility services in areas where localised high demand can be offset to extend overall network capacity. The Company's RIIO-ED2 Distribution System Operator Strategy focuses on the delivery of flexible services and connections to 2028. Overall, the Company alongside sister company SEPD, will invest around £70m in DSO capabilities in the five-year period, enabling greater consumer take-up of low-carbon technologies while delivering an estimated £460m of benefits through deferred reinforcement and avoided capital expenditure.

In April 2022, the UK Government's British Energy Security Strategy recognised the importance of strategic network investment which is essential to meeting the expected demand growth in RIIO-ED2 and future price control periods. DNOs will unlock billions of pounds in investment in wider economic benefits for a net zero future.

Building a Workforce for the Future

During the RIIO-ED2 price control period, the Company will increase its workforce materially as it delivers the infrastructure required for net zero, safely, efficiently and in line with customers' expectations. In the last year alone, the graduate intake increased by 180% and trainee engineers by 90% for the Company and sister company SEPD, with specific pipelines for digital skills, alignment to and a focus on recruiting for difference, including neurodiversity.

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Strategic Report (continued)

Electricity Distribution priorities

The Company's priorities in 2023/24 and beyond are to:

- operate safely and meet all compliance requirements;
- provide an excellent service to all customers who rely on their networks and related services;
- deliver required outputs while maintaining tight controls over expenditure;
- maintain good progress in the safe delivery of new assets including submarine cables;
- continue to work with stakeholders in developing a sustainable long term energy solution for Shetland;
- progress innovations that will improve network reliability, efficiency and customer service and inform industry-wide improvements;
- develop and maintain effective stakeholder relationships and conduct constructive engagement with regulators and legislators, advocating clarity and stability in the regulatory framework including getting ready for RIIO-ED2; and
- progress the transition towards operating in a DSO environment.

Values and responsibilities

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

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

Factors affecting the business

The Company is responsible for managing the electricity distribution network in the licensed Highlands and Islands, North Caledonia and South Caledonia regions in the north of Scotland. The Company also operates electricity connections within a number of out of area electricity networks in the rest of Scotland. Distribution of electricity within specified areas is a monopoly activity and the level of allowed revenue for the use of the system is closely regulated by Ofgem, as is the level of investment made.

Against this background, the Company's objective is to manage the consequences of the change in demand for electricity, changes to the generation mix and to ensure the network has the minimum number of faults and the maximum robustness in the face of severe weather and other supply interruption risks.

Other factors which would affect the longer-term performance of the business would include the macroeconomic situation and impact on the Company's funding costs, and the performance of the Company and its contractors on delivery of capital projects. The former is addressed by the Group's treasury policies to ensure that appropriate funding is available to the business. The latter is addressed by use of the Group's Large Capital Project (LCP) Governance Framework which is designed to ensure projects are governed, developed, approved and executed in an effective manner. All significant capital projects are governed by this framework.

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Strategic Report *(continued)*

Understanding and managing our principal risks

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

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

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

- **Safety, Health and Environment**

The Company's operations are in many cases undertaken in hazardous environments and involve working with high voltage electricity in a wide variety of locations. Some of our operations require the storage of a significant volume of fuel, oil and other chemicals, and any uncontrolled release of these could result in injury to our staff, contractors or members of the public and damage to the environment. Safety is the number one value and priority for the Group and Company. There is a Safety Management System in place to support people at work and ensure their safety and significant focus on both technical and behavioural safety training. In addition, crisis management and business continuity plans are in place to manage and recover from any significant events.

- **Political and Regulatory Change**

Our business continues to be subject to political, regulatory and legislative demands and changes. The Political and Regulatory Engagement Policy is supported by a Communication, Regulation and Stakeholder Engagement Directorate which directly manages the political engagement for the Company with key political stakeholders, while maintaining a healthy and ongoing relationship with the regulator.

- **Legislative and Regulatory Compliance**

Regulation, legislation and compliance affecting the Company is complex and fast-moving. Changes, either explicit or indirect, can lead to additional obligations and can have a significant effect on the profitability of our asset base. This risk is mitigated jointly by Company management and staff along with the Group's dedicated Corporate Affairs, Regulation, Legal and Compliance departments which provide advice to the Company on the interpretation of political and regulatory change. The Company's regulatory obligations are reported in accordance with the Regulatory Instructions and Guidance (RIGS) and Data Assurance license conditions which have a substantial governance regime behind each submission. In addition, there is proactive engagement with regulators, politicians, officials and other stakeholders on these issues.

- **Network Delivery & Operational Management**

The Company has an obligation to maintain and enhance its network and ensure its resilience. Failure to manage the operational network performance where external factors can affect operability that may result in loss of supply, customer dissatisfaction and regulatory penalties. A robust asset management and quality assurance process is in place to ensure that equipment is of the correct standard and specification to provide a safe, efficient and reliable network now and in the future. The impact of adverse weather on our network infrastructure is an annual event and due to the ongoing impact of global climate change, it is anticipated that the volume and impact of these events will increase. The Company has many years' experience in dealing with these events and there is significant effort directed to forecasting such events and ensuring that there are plans in place to deal with them, both in the control room and in the field. This involves early deployment of staff to potentially affected areas and ensuring sufficient staff and other resources are available to effectively deal with any disruption.

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Strategic Report *(continued)*

Understanding and managing our principal risks *(continued)*

- **Cyber Security Resilience**

With the increased incidence of cyber-attacks over recent years there is a risk to the Company's key systems and, as a result, the infrastructure network could be compromised or rendered unavailable. To mitigate this risk, the Group and Company are investing in a long-term security programme including liaising with relevant external stakeholders, maintaining business continuity plans and disaster recovery sites, and ensuring staff awareness of IT security issues and their importance.

- **Network Engineering and Asset Management**

The Company continues to manage the ever changing demands placed on network assets. Failure to monitor and understand network asset health conditions could compromise the targeted investment strategy, resulting in a decline of network performance with resulting penalties and reputational damage. It is critical that these projects are delivered on time, on budget and to a high standard given the long-term nature of the business. The Investment Management Framework facilitates for the robust evaluation of every decision based on safety and environment, costs, risks and performance implications over the whole asset lifecycle. Clear roles and responsibilities are established within asset management, the technical design authority and the Electricity Distribution sub-committee which oversees the investment plan. The roll-out of continuous staff training programmes on network data management offers further support.

- **Financial Management**

The Company continues to manage the risk of exposure to fraud, bribery and corruption. The Company has in place sufficient financial and procurement controls which can support the use of a complex global supply chain. The Financial team actively mitigates this risk through the design and implementation of strengthened controls within the business, while mandatory Fraud, Bribery, Corruption and Financial Sanctions training is required of all staff. In addition to this, the Company has a presence on the Group Anti-Financial Crime Steering Group, which involves periodic submissions on Corruption and Anti-Financial crime.

- **Customer Safety and Relationship Management**

The Company continues to manage and meet Customer and third party expectations, including Asset Owners, Retail Group and local authorities, in order to prevent customer and stakeholder dissatisfaction and associated reputational and financial loss. The Company mitigates this risk through the work of stakeholder advisory panels, local and community resilience plans and continuous training for customer facing staff. Regional engagement roles and relationships are established within the Company's communities, while a stakeholder mapping and vulnerability tool has been established to support customer requirements.

- **Change Transformation**

The energy industry is undergoing constant technological and regulatory change. It is important that the Company is able to stay at the forefront of the industry by identifying emerging trends and developing strategies to exploit competitive opportunities. Through the RIIO-ED1 settlement and now progressing through RIIO-ED2, the Company has proposed significant reductions in the overall cost and improvements in the standard of service that customers can expect to receive. To deliver this successfully, the Company will continue to transform the business and people, delivering major cost efficiencies, new IT systems and improvements in customer service. The Company has in place a RIIO-ED2 blueprint and a Change Delivery Project Team to aid this, while maintaining strong governance processes and procedures at Board and Leadership team levels to monitor the transformation process.

- **People and Culture**

In order to support a strong business culture which meets the demands of the customer focused delivery model, the Company must continue to attract, develop and retain a skilled workforce. In order to mitigate the risk of failing to attract talent, the Company continues to enforce a People Strategy which delivers on highlighting the value in attracting an inclusive and diverse workforce. Through the Networks People Sub Committee and its continuous management of talent and execution of an effective recruitment strategy, the operating model will continue to achieve high performance whilst maintaining an inclusive culture.

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Strategic Report *(continued)*

Understanding and managing our principal risks *(continued)*

- **Sustainability**

The Company continues to transition the network to a flexible system which can accommodate international climate and government net zero carbon economy goals. Ambitious targets in respect of electric vehicles and smarter electricity systems usage inevitably increase expectations of investors and stakeholders. The Company business strategy remains firm and has hardwired the transition to net zero to its core, building the assets, infrastructure and services to help achieve decarbonisation. The Distribution Executive Committee continues to work to identify, quantify and articulate social and environmental impacts in a way that generates value for society whilst ensuring the network does not fail to achieve the targets set.

Section 172(1) Statement

Section 172 of the Companies Act 2006 requires a director of a company to act in the way he or she considers, in good faith, would most likely promote the success of the company for the benefit of its members as a whole. In furtherance of this, section 172 requires a director to have regard amongst other matters, to the:

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

In discharging their section 172 duties, the Directors of the Company, have regard to the factors set out above. They also have regard to other factors which they consider relevant to the decision being made. Those factors, for example, include the Company's applicable regulatory and legal obligations.

The Directors acknowledge that every decision will not necessarily result in a positive outcome for all of the Company's stakeholders. However, by considering the Company's purpose and values, together with its strategic priorities, and having agreed processes in place for decision-making, they do aim to ensure that decisions are consistent and appropriate in all circumstances. Details of the mechanisms which are in place to assist the Directors in understanding relevant views, including how these have been considered during the year, are set out in pages 10 to 14.

As is normal for large companies, authority for day-to-day management of the Company is delegated to senior management, with the setting and oversight of business strategy and related policies remaining the responsibility of the Directors. The Company's statement on its corporate governance arrangements on page 18 sets out further details of how this is governed within the SSE Group and the Company.

The Company is represented by the Directors on the Distribution Executive Committee which reviews health and safety, financial and operational performance and legal and regulatory compliance at every meeting, in addition to other pertinent areas over the course of the financial year, including:

- the Company's business strategy;
- key risks;
- stakeholder-related matters;
- diversity and inclusion;
- environmental matters;
- corporate responsibility; and
- governance, compliance and legal matters.

This is done through the consideration and discussion of reports which are sent in advance of each meeting and through presentations to the Distribution Executive Committee. In accordance with the Company's governance framework, the Board of Directors review the health and safety, financial and operational performance, and legal and regulatory compliance throughout the financial year. Some decisions are reserved matters for the Group Board of Directors as stipulated within the governance framework for the Company.

Scottish Hydro Electric Power Distribution plc

Strategic Report *(continued)*

Section 172(1) Statement *(continued)*

The strategic and operational priorities of the Company are compared to its long-term targets and obligations to shareholders, the regulatory framework for which it is governed by, and the contribution to society and other key stakeholders. The nature of the Company's principal activity is to invest, maintain and operate the electricity network in the north of Scotland which means it actively engages and promotes societal welfare. The investment in electricity distribution assets is to improve network resilience, reduce faults, and improve network reliability for the benefit of society. Additionally, there has been significant investment in the distribution network infrastructure to facilitate the continued drive towards the electrification of transport and heat. This supports the governments net zero emissions targets which benefits society as a whole. The Company continues to advocate for investment in line with the RIIO-ED2 business plan.

In line with the above, the Distribution Executive Committee, during the financial year, approved several capital investment projects to proceed to full construction as set out in the Company's Financial Authorisation Policy. This included specific projects that required further financial approval by the Company's Board of Directors as well as those that required financial approval by SSE Group Board of Directors. This included the required investment to ready the network for net zero, considerate of stakeholder requirements whilst ensuring reliability and efficiency of delivery. The key executive level engagement in 2022/23 was the RIIO-ED2 Final Determination and associated engagement plan which Ofgem published in December 2022.

Stakeholder engagement

The Company's stakeholders are people, communities and organisations with an interest or concern in its purpose, strategy, operations and actions, and who may be affected by them. This includes: shareholders and debt providers; employees; government and regulators; NGOs (non-governmental organisations), communities and civil society; suppliers, contractors and partners; and customers. The perspectives, insights and opinions of stakeholders are recognised as a key factor in the relevant operational, investment and business decisions taken by the Company and its Directors, to ensure that as a whole they are more robust and sustainable.

While there are cases where the Directors may judge it appropriate to engage directly with certain stakeholder groups, the size and spread of both the Company's stakeholders and those of the Group, of which the Company sits within, means that stakeholder engagement takes place at many different levels. This includes at Group level, business unit level, company level and operational level. This holistic approach avoids operating in isolation and allows a broader representation and deeper understanding of all stakeholder views and contributes towards a greater outcome for business, environmental, social and governance matters.

If the UK is to fully decarbonise the economy by 2050, this will require both a significant increase in electricity demand and a fundamental shift in the way it is consumed as millions more electric vehicles, hundreds of thousands of heat pumps and embedded generation and storage come onto the system in the coming years. That means the Company's distribution network has a critical role to play and the next RIIO-ED2 price control period is key to unlocking the strategic, anticipatory investment required to deliver the resilience, flexibility and responsiveness required.

The Company has consulted extensively with all stakeholders to build a robust and compelling business plan and there is excitement about the role the Company can play in the transformation journey that lies ahead.

The Company continues to adapt and seek improved engagement opportunities with customers, suppliers and other key stakeholders. In doing so, the Company also adheres to the Group's wider stakeholder engagement strategy. For more information regarding the Group's approach to stakeholder engagement, please see the 2022/23 Annual Report available at www.sse.com.

Employees

The Group and the Company's strategy includes being a great place to work, providing an inclusive, fulfilling and high-performing workplace. This means maintaining a healthy business culture; adopting a responsible approach to employee relations; providing good employee benefits; and enabling people to develop their careers.

Scottish Hydro Electric Power Distribution plc

Strategic Report *(continued)*

Stakeholder engagement *(continued)*

Employees (continued)

Safety remains as the Group and the Company's first priority with the objective that 'everyone gets home safe'. The Group and Company continue to prioritise safety and health through immersive safety training programmes combined with the launch of a new Health Hub. Through this free of charge service, employees and their immediate families can access 24/7 GP consultations and other health related advice. A programme in partnership with the British Heart Foundation on cardiovascular assessments was also introduced and will continue into 2023/24.

The Group and Company has emphasised the importance of parity of focus between mental and physical health, with initiatives including mental health and wellbeing programmes, and trained a number of employees as Mental Health First Aiders.

The innovative solutions required to deliver net zero need a workforce with diverse perspectives, different experiences, and new skills. Over 2022/23, the Group and the Company has placed an emphasis on inclusion and diversity, recognising that this is an essential driver to deliver net zero in a way that is fair and affordable.

The Group and the Company have a range of employment policies which clearly detail the standards, processes, expectations and responsibilities of its people and the organisation. These policies were in place for the duration of the year, and are designed to ensure that everyone, including those with existing or new disabilities and people of all backgrounds, are dealt with in an inclusive and fair way from the recruiting process on through their career. This includes access to appropriate training, development opportunities and job progression. Further details of this approach can be found on pages 58 to 63 of the SSE plc Annual Report 2023.

Rewarding employee contribution

Employees at all levels within the Group are measured against the same framework, and the formal bi-annual performance review sessions are designed to feedback to employees on their performance as well as provide structured career conversations which encourage employees to think about their opportunities for personal and professional development. The Group's well-established approach to performance management has a structured framework which assesses employee performance against individual agreed objectives as well as alignment to the core values of Safety, Service, Efficiency, Sustainability, Excellence and Teamwork.

The Group and Company offer a wide range of employee benefits. As well as contractual benefits determined by factors such as seniority and length of service, including a company car/allowance and private medical insurance, the Group offers a comprehensive suite of non-contractual voluntary benefits to all employees. The Company also offers all-employee flexible working arrangements, share plans, 21 weeks of fully paid maternity leave, health benefits, gym membership, childcare vouchers, a holiday purchase scheme, cycle-to-work schemes, salary sacrifice low emissions car scheme and technology loans.

Employee participation

The Group's long-established teamwork value has been an enduring value that guides employees in their day-to-day working lives. The Group ran the annual All-employee survey which had an engagement score of 84% for 22/23 period. The results are viewed as representative of the majority of employee voices and shape the cultural agenda, ensuring that employee sentiment is considered in all key decision making.

The Group and Company engages with all employees through a combination of engagement methods which encourage two-way dialogue between the Board and employees. These include face-to-face discussions at meetings, site visits, and attendance at employee events. With 2022/23 being the first year in which in-person engagements could fully resume, the Board-employee programme travelled to 32 sites encompassing all of SSE's Business Units and several corporate functions.

The Group and Company has continued to use virtual engagement platforms to connect with a larger audience and this has remained a key part of the engagement strategy providing simultaneous access to a diverse audience of roles and locations. The adoption of a diverse range of listening channels continues to support the principle that everyone in the Group should have a voice and is consistent with employee feedback surrounding the benefit of multiple platforms through which to raise areas of interest or concern. In turn, it supports the Board in gathering a fair and representative view of the issues which are important to employees and builds an appreciation of how these may differ by geography, business area, role, and individual circumstances.

Scottish Hydro Electric Power Distribution plc

Strategic Report *(continued)*

Stakeholder engagement *(continued)*

Employee participation (continued)

Exit surveys aligned to the Group and the Company's overall approach to gathering employee engagement insights through its employee engagement survey, allows a comparison of top/bottom scoring answers for ex-employee sentiment. The results are enabling the Group and the Company to gather meaningful and robust insights into why people leave, informing actions which aim to improve the employee experience.

The views of Company employees, as gathered through the Group survey, are reviewed at business unit level by the Distribution Executive Committee. This data is supplemented by monthly KPIs, tailored business unit led engagement and the work of the Group's dedicated non-Executive Director for Employee Engagement, who provides feedback to the Managing Director of each business unit following relevant engagement. The Company also undertakes a standalone engagement survey for employees which performed well and for which there is a clear time-bound action plan to delivery improvements in employee engagement. People strategies and action plans to address employee views are developed and overseen by the business unit Executive Committee/the Directors in response to feedback received.

Customers

The Company has a well-established customer engagement channel to ensure the perspectives of all customers are considered. A significant part of the Company's engagement with the government and the regulator relates to the maintenance and development of reliable and sustainable electricity networks for the benefit of customers, whilst also delivering value for money.

The Company also continuously considers assurances over affordable and accessible energy, providing a quality customer service as well as the responsiveness to vulnerable customers in need. Phasing into the RIIO-ED2 price control period (2023-2028), the Company maintains its commitments to providing a first-class service at a fair price to its customers whilst meeting its key objective in providing a reliable supply of electricity throughout the network.

The Company supports vulnerable customers through encouraging customers in need to sign up to its Priority Services Register (PSR), aiming to provide priority customer service to those on the register during unplanned power outages. It is therefore critical that the Register is comprehensive, accurate and captures all those in need. The PSR initiative also collaborates with emergency services and local authorities to provide extra support to those who are on the register.

The Company is at the forefront of enabling net zero at a local level, operating the electricity distribution network that will facilitate new forms of heating, battery storage and many more electric vehicles. In March 2023, it published a report which explores how net zero can be delivered fairly for consumers, ensuring people can participate in and benefit from the energy transition.

The Directors continue to monitor overall business direction and customer performance to ensure delivery of an appropriate level of service and investment.

Suppliers, contractors and partners

The Company continues to work closely with suppliers to ensure its values on issues such as environmental protection, safety and modern slavery are upheld throughout its supply chain. As the Company integrates climate action alongside its core business strategy and operations, the Company recognises that a key stakeholder in reaching its objectives are its suppliers.

As such, the Company is adopting an approach through effective leadership to collaborate with stakeholders along the supply chain to accelerate ambitions towards its sustainability goals and values. Material considerations include assurances that social and environmental impacts are managed and mitigated, as well as ensuring innovation relating to the project design and delivery supports the Company in the drive to net-zero transition.

In order to ensure that there has been adequate engagement in fostering the Company's business relationships with suppliers, customers and other relevant parties' representations are made on a regular basis at business unit level by business partners which represent the areas of Procurement, Corporate Affairs and Legal within the Company. Such representations are designed to inform the Directors of the current nature of the relationship, the strategic significance that the relationship offers to support the objectives of the business and the prospects or issues associated with the continued fostering of the relationship.

Scottish Hydro Electric Power Distribution plc

Strategic Report *(continued)*

Stakeholder engagement *(continued)*

Suppliers, contractors and partners (continued)

The Company facilitates value-adding conversations on subjects like innovation and future growth whilst ensuring relationships are maintained at all levels, from project teams on the front line through to senior management and Directors. To ensure high operational standards, onsite training is held for contractors and quality and health and safety audits are undertaken by the Group. Given the rise in contractor hours worked in SSE's current growth phase, there is a need for a strategy that builds stronger, more collaborative relationships with supply chain partners to keep everyone safe. The Group has formed a new central Contractor Safety Team in early 2023, supported by dedicated Contractor Managers and Assurance Auditors to improve contractor safety performance.

A joined-up, collaborative approach between government, industry and society is required in 2023/24 and beyond to build sustainable homegrown supply chains to service growth in demand and unlock economic opportunity in all regions.

The Company does not have any energy supply contracts with Russian counterparties, nor will the Company seek Russian counterparty agreements in light of the Ukraine conflict.

Government and regulators

During 2022/23, the Company continued to extensively liaise with regulatory officials and responded to all material regulatory consultations, with dedicated teams working to communicate business strategy and investment decisions. The Company continues to take an active role in the development of regulations and policies which impact upon the Company and its customers. The Directors continue to monitor engagement activity and responses to regulators to ensure that strategic, financial, investment and operating frameworks remain aligned to the external landscape.

Communities

One of the Company's sustainability ambitions, guided by the pillars of the United Nations Sustainable Development Goals (SDGs), is to serve public interest through several key commitments, thus positively impacting local communities. The commitments that relate strongly to communities include:

- Maintaining a safe, reliable and resilient network evidently through investing in upgrades throughout the RIIO- ED2 price control period; and
- Contributing to reputable work and economic growth through creating skilled and sustainable jobs, thus significantly working towards the SDG involving "Decent Work and Economic Growth" by fair and just means, in the hope of providing opportunities for local communities.

The Company also provided enhanced restoration support to customers and worked hard to deliver thousands of hot meals and supported hundreds of referrals for its Priority Service Register customers in its storm response.

The Company secured funding in collaboration with local authorities in the north East of Scotland who worked with the Company to create a comprehensive community-led resilience programme, outlining the projects and initiatives that would most benefit from financial support. While the focus was on community, household and personal resilience projects, specific emphasis was placed on supporting the most vulnerable across each community.

The Company also received the Community Investor Award as a token of recognition for the Company's collaborative first-time initiative with the Shetland Islands Council to connect island communities with fibre optic broadband. As an essential service provider, the Company has a vital role to play to tackle social issues and our commitment to addressing those issues relevant to the most vulnerable in society, remains a strong focus to ensure no one is left behind.

Scottish Hydro Electric Power Distribution plc

Strategic Report *(continued)*

Environment

The Group and the Company continue to step up their efforts in supporting the UK and Scottish Government in achieving global climate goals by working towards a refreshed set of Group business goals for 2030 where sustainability lies at the core of its business. The Company strives to lead an evolving system to support renewable energy generated locally through its flexible electricity networks. This shift provides a plethora of exciting opportunities that involve diverse communities and stakeholders at the heart of the net zero transition through decarbonisation.

The Company is committed to delivering Biodiversity Net Gain by 2025 on all onshore large capital projects in the UK and this target is part of the RIIO-ED2 business plan.

The Company's key environmental sustainability milestone is being the first UK DNO to set science-based targets to decarbonisation in-line with the Paris Agreement by limiting global warming to 1.5 degrees Celsius above pre-industrial levels. The Company also delivers projects that aim to contribute positively towards biodiversity and prevent negative environmental impact.

The Company aims to create a fair and just decarbonised electricity network in the long run, evidently through collaborative work across other networks to support decarbonisation of Scottish transport by producing guidance and supporting information on how fleet operators can switch to electric, in efforts to transition to net zero.

Moving forward with the Group's strengthened 2030 business goals, the Company believes that its efforts in contributing towards the Group's goals of cutting carbon intensity by 80%, increasing renewable energy output by five times, enabling low-carbon generation and demand as well as championing a fair and just energy transition will benefit its stakeholders, society, the environment and the economy in the long run whilst accelerating Net Zero targets. More information on the Group's approach to managing our environmental impact can be found in the 2022/23 Annual Report, available at www.sse.com.

As part of the climate metric in relation to the Greenhouse Gas (GHG) emissions the Company is exempt from making disclosures in line with the Streamlined Energy and Carbon Reporting ('SECR') requirements as it is a wholly owned subsidiary of SSE plc. The consolidated disclosures of the Group are available on pages 49 to 55 of the Group's 2022/23 Annual Report.

Internal control

The Group's Audit Committee performs a review of the effectiveness of the system of internal control annually across the Group. This covers all material controls including financial, operational and compliance controls.

During the year, the Committee received an update at each meeting from the project team covering legislative and regulatory developments, progress on implementation and validation of Finance and IT controls, and the change programme to support the Company's adoption of the new framework from 1 April 2025. Following the Committee's review and recommendation, the Board agreed that SSE's System of Internal Control (including risk management) continues to be effective. This was in accordance with the requirements of the FRC Guidance on Risk Management, Internal Control and related Financial and Business Reporting

Considering continuous improvement actions, the Board also confirms that no significant failings or weaknesses have been identified during the financial year. Processes are in place to ensure that necessary action is taken and progress is monitored where areas for improvement have been identified.

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

No system of control can, however, provide absolute assurance against material misstatement or loss. Accordingly, the Directors have regard to what controls, in their judgement, are appropriate to the Company's business, to the materiality of the risks inherent in the business, and to the relative costs and benefits of implementing specific controls. This process is regularly reviewed by the Board and has been in place for the whole year.

Scottish Hydro Electric Power Distribution plc

Strategic Report *(continued)*

Key contractual arrangements

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

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

Operational resources available

The Company has 1,389 employees which it calls on to maintain its distribution network and carry out investment in future developments. The Company also draws upon Group shared services covering central functions such as finance, HR, regulation, health and safety, company secretarial and insurance services. All such services are provided under an appropriate Service Level Agreement.

In addition to these employees, the services of key contractors are called upon in a number of large capital projects to ensure that these projects are delivered on time and on budget.

Capital structure

The Company regards its capital as comprising its equity, cash and borrowings. Its objective in managing capital is to maintain a strong balance sheet and credit rating so as to maintain investor, creditor and market confidence and to sustain future development of the business.

Treasury policy, objectives and financial risk management

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

Exposure to currency and interest rate risk arises in the normal course of the Company's business. Derivative financial instruments are entered into to hedge exposure to these risks. The objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the year are explained in note 20.

The Company's financial risk is managed as part of the wider Group risk management policy. For more information regarding the Group's approach to financial risk management, please see the 2022/23 Annual Report available at www.sse.com.

Liquidity, borrowings and financial resources available

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

As part of the Group, the Company has significant resources which it can draw upon to meet its service commitments. The Company benefits from Group-wide treasury management functions in order to provide adequate financing, with committed bank facilities of £3.5bn 31 March 2023 and undrawn facilities totalling £3.4bn available to the Group at 31 March 2023 of which £1.75bn could be made available to the Company if required. These facilities are:

- a £1.3bn revolving credit facility for SSE plc maturing March 2026 (2022: £1.3bn);
- a £0.2bn bilateral facility for SSE plc maturing October 2026 (2022: £0.2bn); and
- a new £0.25bn facility for the Company and SEPD maturing November 2025 (2022: £nil).

Scottish Hydro Electric Power Distribution plc

Strategic Report *(continued)*

Treasury policy, objectives and financial risk management *(continued)*

The Company's joint facility with sister company SEPD was entered into to help cover the capital expenditure and working capital of the Company and has a one year extension option at the borrower's discretion.

The Company has loans of £823.1m (2022: £804.2m) of which £650.0m (2022: £650.0m) is due to other Group companies. Of the total, interest is paid at fixed rates on £650.0m (2022: £650.0m). The remaining loan amounts to £173.1m (2022: £154.2m) which is an index-linked bond.

As at 31 March 2023, the weighted average interest rate payable was 2.29% (2022: 2.29%) and the weighted average remaining term was 12.01 years (2022: 13.74 years).

Taxation

The headline effective tax rate, which includes the impact of substantively enacted changes in the UK corporation tax rate, is 22.0% compared with 59.3% in the previous year. The movement is a result of the prior year deferred tax adjustment relating to the corporation tax rate change to 25% in respect of periods commencing after 1 April 2023, which was substantively enacted on 24 May 2021.

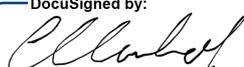
Dividend

The Directors did not declare a dividend for the year ended 31 March 2023 (2022: *Nil*).

Pensions

6% (2022: 8%) of employees of the Company are members of the Scottish Hydro Electric Pension Scheme, which, at 31 March 2023 on an IAS 19 basis had a surplus, net of deferred tax, of £275.0m included in the Group Financial Statements (2022: £388.1m).

On behalf of the board

DocuSigned by:

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Chris Burchell
Director
21 July 2023

Scottish Hydro Electric Power Distribution plc

Corporate Governance Statement

As a subsidiary company of the Group, the corporate governance arrangements which apply to the Company are defined by SSE's Group Governance Framework. This is set out on pages 122 and 123 of the SSE plc Annual Report, with the Company being part of the SSEN Distribution business unit.

The Group Governance Framework is reflective of the Principles and Provisions of the UK Corporate Governance Code (the Code) which apply to the parent company, SSE plc. It defines the delegation of authority and accountability within the Group, enables review and challenge of management performance, is a pillar of SSE's System of Internal Control, and supports the processes by which principal and emerging risks are identified and managed. The Directors of the Company discharge their duties in line with the governance standards and processes agreed at Group level.

The Company itself does not have listed shares and therefore is not subject to the Code. It has not voluntarily applied the Code nor another publicly available corporate governance code and has instead operated within the Group Governance Framework described above and below.

The Group's approach to corporate governance and compliance with the Code can be found in the Directors' Report within the SSE plc Annual Report and Accounts 2023 at www.sse.com/reportsandresults.

SSE plc Group ("the Group")

The Group's core purpose is to provide energy needed today, while building a better world of energy for tomorrow. Its vision is to be a leading energy company in a net-zero world and its strategy is to create value for shareholders and society in a sustainable way by developing, building, operating and investing in the electricity infrastructure and businesses needed in the transition to net zero. All of which are underpinned by SSE's core values: Safety, Service, Efficiency, Sustainability, Excellence and Teamwork; that are designed to guide decisions and actions within SSE and contribute to the overall culture.

The above matters are reserved for, and set by, the Group Board, who ensures that purpose, strategy, values and culture are aligned. Subsequent implementation is a responsibility of the SSE Group Executive Committee. Each business unit, and in turn, subsidiary Company and its Directors, is further accountable to executive management and ultimately the Group Board, for executing supporting business strategies within agreed Group parameters and promoting the desired culture. The Directors therefore set the strategic aims of the Company, supervise management, monitor and report on performance, approve investment within delegated levels and are responsible for all statutory and regulatory approvals. These responsibilities are set out in agreed Terms of Reference.

More on the Company's strategy and business objectives can be found from page 2 of the Strategic Report.

More on SSE's strategy can be found on page 8 to 11 of the SSE plc Annual Report and more on culture can be found on page 137 to 138.

There are five principal Board committees: a Nomination Committee, an Audit Committee, a Safety, Health and Environment Advisory Committee, an Energy Markets Risk Committee, and a Remuneration Committee. Full details of the role of each Committee, membership and work undertaken during 2022/23 is set out in the published annual report of the Group, which is available at www.sse.com.

On 31 March 2023, Dame Sue Bruce stepped down from the Board following just over nine years' service and Lady Elish Angiolini becomes SSE's non-Executive Director for Employee Engagement with effect from 1 April 2023. John Bason joined SSE plc's Board as a new Non-Executive Director on 1 June 2022 and will succeed the role of Audit Committee Chair from 21 July 2023 when Peter Lynas steps down from the Board. Maarten Wetselaar will be appointed as a new Non-Executive Director from 1 September 2023. Gregor Alexander announced his decision to retire in April 2023 and will be replaced in his role as Chief Financial Officer from 1 December 2023 by Barry O'Regan, current Finance Director for SSE Renewables.

The Board now comprises the Chairman, three Executive Directors, a Senior Independent Director and seven independent non-Executive Directors. This gives the Board a good balance of independence and experience, ensuring that no one individual or group of individuals has undue influence over the Board's decision making.

Scottish Hydro Electric Power Distribution plc

Corporate Governance Statement *(continued)*

Scottish Hydro Electric Power Distribution plc (“the Company”)

The following comments on the arrangements for the Company.

Board of Directors

During the year the Board comprised six Executive Directors and five Non-Executive Directors one of whom is the Chair of the Board, an Executive Director of the Group and member of the Group Executive Committee. None of the Directors are Directors of Group Companies involved in Retail or Wholesale activities. Two of the Non-Executive Directors on the Board during the course of the financial year were Sufficiently Independent Non-Executive Directors as required under the terms of Standard Condition 43A of the Company’s regulatory licence. As the Company is a wholly owned operating subsidiary within the SSE Group, the Directors believe that the Board is of an appropriate size in the context of the overall Group Governance Framework.

The Executive Directors are experienced senior business leaders and are deemed to possess the appropriate breadth of knowledge and expertise to discharge their role effectively. The Non-Executive Directors provide an appropriate degree of independent judgement and challenge to ensure balanced and fair decision-making and outcomes. The operation and effectiveness of the Board is the ultimate responsibility of the Chair, who is supported in their role by the Company Secretary. Agreed procedures are in place to manage and mitigate actual or potential conflicts of interest with Board or Company business.

The Board does not have a supporting Nomination, Remuneration or Audit Committee. These functions are dealt with, where required, in conjunction with the relevant committee of the SSE Group Board.

SSE has a Group-wide inclusion and diversity strategy including self-led gender ambitions, details of which can be found on pages 60 to 62 of the SSE plc Annual Report. Any changes and appointments to the Board consider both SSE’s approach to inclusion and diversity and the desire to have a Board which is balanced overall and supports the Company’s needs.

Changes to the Board

The SSEPD Board governed the Company’s activities until 25 November 2022. All SSEPD Board members transferred to the Company Board on the 25 November 2022 and convened until the year ended 31 March 2023. A planned Board restructuring exercise has taken place from 3 April 2023 to align with the Company’s current and future strategy plan.

Gregor Alexander stepped down as Chairman of the Board on 3 April 2023 and Alistair Phillips–Davies, current SSE Group Chief Executive, was appointed to the role of Chairman of the Board as a Non-Executive Director on the same date.

The Board met nine times during the course of the year ended 31 March 2023 and individual Director attendance is set out below.

Director	Attendance
Gregor Alexander (Non-Executive Director, Chairman) (Resigned 03/04/2023)	9 of 9
Rob McDonald (Resigned 03/04/2023)	9 of 9
Chris Burchell	7 of 9
Eliane Algaard	9 of 9
Mark Rough	7 of 9
Sandy Mactaggart (Resigned 03/04/2023)	7 of 9
Maz Alkirwi (Resigned 03/04/2023)	9 of 9
Rachel McEwen (Non-Executive Director) (Resigned 01/05/2023)	8 of 9
Katherine Marshall (Non-Executive Director)	9 of 9
David Rutherford (Independent Non-Executive Director)	9 of 9
Gary Steel (Independent Non-Executive Director) (Resigned 01/05/2023)	9 of 9

Scottish Hydro Electric Power Distribution plc

Corporate Governance Statement *(continued)*

Board effectiveness

On appointment all Directors receive induction to the Board and briefings on areas pertinent to their role such as a Director's legal duties. The ongoing effectiveness of the Board is supported by performance evaluation and a commitment to personal development and training by each Director.

Regular Board evaluation is facilitated by the Company Secretary, through which the Director's reflect upon, and agree, areas for improvement based on an objective assessment of the Board's operations. Following such assessments, actions are implemented and tracked in advance of further performance evaluations in 2023/24.

Opportunity, Risk, and Internal Control

The long-term sustainable success of the Company, including the opportunities and risks to this, are explicitly considered by the Directors and within strategic decision making. Further details can be found throughout the Strategic Report.

Remuneration

The Remuneration of the Director's is set in line with overall SSE Group policy and further information can be found in note 5.

Stakeholder relationships and engagement

Details of the Company's stakeholders and the associated engagement which takes place can be found throughout the Strategic Report.

Going Concern

The Directors assess that the Financial Statements should be prepared on a going concern basis.

In making this assessment, the Directors have considered the impact of a number of severe but plausible scenarios as identified by the Distribution Executive Committee. These are detailed within the Principal Risks outlined in the Company's Strategic Report. As it is highly unlikely that all scenarios could or would manifest in any single financial year, the Directors have considered an extreme combination which assumes the inclusion that the "Alternative Technologies", "Network Resilience & Delivery", "Safety, Health & Environment", "Network Transformation", "Legislative & Regulatory Compliance", "Financial Management", and "Cyber Security" risks manifest in the same year – these being the Principal Risks with the greatest financial impacts.

Additional cash flow modelling, including the impact of periods of reduced demand and stressed conditions on the Company's ability to refinance maturing debt, was carried out against which operational and financial mitigants were also considered. This cash flow modelling displays the potential prospective impact on the financial position of the Company for the foreseeable future, based on plausible downside scenarios which may materialise over the coming period.

This has been supported by the provision of a parental letter of support from SSE plc. The Group letter of support confirms that the Group will provide support to 31 December 2024 where required. The Directors are satisfied that the Group has the ability to provide this support, should it be required.

In assessing the financial strength of the letter of support provided, the directors considered the cash and cash equivalents balance of £891.8m at 31 March 2023, and the undrawn committed bank facilities of £2.75bn maintained by the Group. In coming to this conclusion, the Directors have taken into account the Group's credit rating and the successful issuance of £1.6bn of long term funding in the 22/23 financial year being a €1bn NC6 Hybrid at 4% in April 2022, a 7 year €650m Eurobond at a coupon of 2.875% and a £350m dual tranche US Private Placement. As well as taking account of the factors noted, the going concern conclusion is arrived at after applying stress testing sensitivities to the Group's cash flow and funding projections including removal of proceeds from unconfirmed future divestments, negative and positive sensitivities on operating cash flows and uncommitted capex and other adjustments.

Having reviewed the financial strength of the Group, the directors are satisfied that the Group, and the Company itself, will remain funded for foreseeable future. The Directors have therefore concluded it is appropriate for the financial statements to be prepared on a going concern basis.

Scottish Hydro Electric Power Distribution plc

Corporate Governance Statement *(continued)*

Viability Statement

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

In doing so, the Board has assessed the prospects of the Company over the next 4 financial years to 31 March 2027. The Directors have determined that as this time horizon aligns with the Company's capital programme and is within the strategy planning period, a greater degree of confidence over the forecasting assumptions modelled can be established.

This statement is included solely for information.

In making this statement the Directors have considered the resilience of the Company taking into account its current position, the Principal Risks it faces and the control measures in place to mitigate each of them. In particular, the Directors recognise the significance of the Company's regulated revenue stream, strong balance sheet and access to available resources including the SSE Group's undrawn committed lending facilities of £1.75bn.

To support this statement, over the course of the year a suite of severe but plausible scenarios has been developed for each of the Principal Risks facing the Company and stress testing has been undertaken against available forecast financial headroom. Examples include critical network failure (for Network Operational Management) and impact of a cyber-attack to our IT network (for Cyber Security Resilience).

Upon the basis of the analysis undertaken, and on the assumption that the fundamental regulatory and statutory framework in which the Company operates does not substantively change, the Directors have a reasonable expectation that the Company will be able to continue to meet its liabilities as they fall due in the period to 31 March 2027.

Scottish Hydro Electric Power Distribution plc

Directors' Report

The Directors present their report together with the audited Financial Statements for the year ended 31 March 2023.

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

1 Principal activities

The Company is responsible for managing an electricity distribution network, serving over 0.7m customers in the north of Scotland. Distribution of electricity and the level of capital investment within the network area is a monopoly activity and is closely regulated by Ofgem within a framework known as the price control. The Company also carries out the business of provision of new electrical connections services within its licensed area and the construction and management of out-of-area electricity networks in Scotland. A full review of the year including the Company's future development is contained within the Strategic Report section of these Financial Statements.

2 Results and Dividends

The profit for the financial year amounted to £48.3m (2022: £28.1m). The Directors did not declare a dividend in the year (2022: £nil).

3 Directors

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

4 Indemnification of Directors and insurance

The Directors have the benefit of an indemnity provision contained in the Company's Articles of Association. In addition, the Directors have been granted a qualifying third-party indemnity provision which was in force throughout the financial year and remains in force. Also, throughout the financial year, the Company purchased and maintained Directors' and Officers' liability insurance in respect of itself and for its Directors and Officers.

5 Political donations and expenditure

The Company operates on a politically neutral basis and does not make any donations to political parties, political organisations or independent election candidates. During the year, no political expenditure was incurred and no political donations were made by the Company.

6 Corporate governance

The Corporate Governance Statement for the Company is outlined on page 18.

7 Accounting policies, financial instruments and risk

Details of the Company's policies with regard to financial instruments and risk, are provided in Note 20 to the Financial Statements.

8 Research and development

The Company is involved in a range of innovative projects and programmes which are designed to progressively transform the energy system. A number of these projects and programmes are referred to in the Strategic Report in pages 2 to 17.

Scottish Hydro Electric Power Distribution plc

Directors' Report *(continued)*

9 Employment of disabled people

The Company has a range of employment policies which clearly detail the standards, processes, expectations and responsibilities of its people and the organisation. These policies were in place for the duration of the year, and are designed to ensure that everyone, including those with existing or new disabilities and people of all backgrounds, are dealt with in an inclusive and fair way from the recruiting process on through their career. This includes access to appropriate training, development opportunities and job progression.

10 Auditor

Each of the Directors who held office at the date of approval of this Directors' Report confirms that, so far as each Director is aware, there is no relevant audit information of which the Company's Auditors are unaware and each Director has taken all the steps that ought to have been taken in his or her duty as a Director to make himself or herself aware of any relevant audit information and to establish that the Company's Auditors are aware of that information.

The Directors have appointed Ernst & Young LLP as auditors of the Company in accordance with section 485 of the Companies Act 2006.

On behalf of the Board:

DocuSigned by:

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Helen McCombe
Company Secretary
21 July 2023

Scottish Hydro Electric Power Distribution plc

Statement of Directors' responsibilities in respect of the Strategic Report, the Directors' Report and the Financial Statements

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 they have elected to prepare the Financial Statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 101. Under company law the Directors must not approve the Financial Statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of its profit or loss for that period. In preparing the Financial Statements, the Directors are required to:

- select suitable accounting policies in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and reliable;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements FRS 101 is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company financial position and financial performance;
- state whether applicable UK accounting standards, including FRS 101, have been followed, subject to any material departures disclosed and explained in the Financial Statements;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

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

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

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

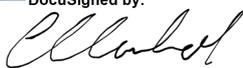
Responsibility statement of the Directors in respect of the annual financial report

We confirm that to the best of our knowledge:

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

We consider the Annual report and Financial Statements to be fair, balanced and understandable and provides the information necessary for users to assess the Company's position and performance.

On behalf of the Board:

DocuSigned by:

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Chris Burchell
 Director
 21 July 2023

Independent Auditor's Report to the Members of Scottish Hydro Electric Power Distribution plc

Opinion

We have audited the financial statements of Scottish Hydro Electric Power Distribution plc for the year ended 31 March 2023 which comprise Profit and Loss Account, Statement of Other Comprehensive Income, Balance Sheet, Statement of Changes in Equity and Cash Flow Statement and the related notes 1 to 24 including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards including FRS 101 "Reduced Disclosure Framework (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the Company's affairs as at 31 March 2023 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Our evaluation of the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting included the following procedures:

- We confirmed our understanding of management's Going Concern process;
- We obtained board approved cashflow forecasts for the company and sensitivities prepared by management to 31 December 2024 (the 'going concern period'). We tested the arithmetical accuracy of the models and performed reverse stress testing to understand how plausible the severe downside scenarios would need to be to result in negative liquidity;
- We understood that management have assumed that access to group financing, being the revolving credit facility maintained by SSE plc, will continue during the going concern period and we obtained a copy of the letter of support issued to the directors of the Company from SSE plc confirming this;
- We have considered the ability of the company to rely on parent company support; and
- We considered whether management's disclosures in the financial statements sufficiently and appropriately reflect the going concern assessment and outcomes.

In considering the ability of the company to rely on the parent company support, the following procedures were performed over the group and parent company's going concern assessment:

- We confirmed that the cash flow forecasts prepared by management were consistent with those considered in the Group Going Concern model;
- We confirmed our understanding of group management's Going Concern process as well as the review controls in place over the preparation of the group's Going Concern model and the memoranda on going concern;
- We confirmed that all expected risks to going concern were included within management's going concern assessment;
- We obtained group management's board approved forecast cash flows, covenant forecasts and sensitivities prepared by management to 31 December 2024, ensuring the same forecasts are used elsewhere within the group for accounting estimates and that the forecasts reflect the spend to come on the £18bn committed as part of the NZAP Plus programme. We tested the models for arithmetical accuracy, as well as checking the net debt position at the year-end date which is the starting point for the model;
- We assessed the reasonableness of the cashflow forecast by analysing group management's historical forecasting accuracy. We also ensured climate change considerations were factored into future cash flows, including the impact of adverse weather events;

Independent Auditor's Report to the Members of Scottish Hydro Electric Power Distribution plc (*continued*)

- We performed reverse stress testing on group management's forecasts to understand how plausible the severe downside scenarios would need be to result in negative liquidity or a covenant breach and how plausible were the scenarios. The EY assessment included consideration of all maturing debt through to 31 March 2025;
- We reviewed group management's assessment of mitigating options potentially available to the company to reduce cash flow spend in the Going Concern period, to determine their plausibility and whether such actions could be implemented by management. We have obtained support to determine whether these were within the control of management and evaluated the impact of these mitigations in light of our understanding of the business and its cost structures;
- We performed a detailed review of borrowing facilities to assess their continued availability to the company and to ensure completeness of covenants identified by group management;
- We reviewed market data for indicators of contradictory evidence to challenge the Going Concern assessment, including review of profit warnings within the sector and review of industry analyst reports.

Our key observations

The Company is forecast to continue to be profitable during the going concern period. The Company has committed to significant capital expenditure in the going concern period, for which additional funding will be required. The strength of the ability of the Company to raise new funds is evidenced by successful borrowings secured in recent years. In the unlikely event that the Company is unable to secure external funding, a letter of support has been received from SSE plc confirming that the Company will continue to have access to the revolving credit facility throughout the going concern period.

The reverse stress testing performed indicated that the Company would need to be exposed to severe downside events impacting profitability and cash flows in order to breach liquidity. Management considers such a scenario to be highly unlikely, however have demonstrated that continued access to the parental support offered by SSE plc mitigates the impact of this scenario.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period 31 December 2024

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

Overview of our audit approach

Key audit matters	<ul style="list-style-type: none"> • Carrying value of PP&E, specifically risks around incorrect cost capitalisation • Management override of controls, specifically around revenue recognition
Materiality	• Overall materiality of £2.9m which represents 5% of Profit before tax

An overview of the scope of our audit

Tailoring the scope

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

Changes from the prior year

There were no significant changes to the scope of our audit from the prior year.

Independent Auditor's Report to the Members of Scottish Hydro Electric Power Distribution plc (*continued*)

Climate change

There has been increasing interest from stakeholders as to how climate change will impact Scottish Hydro Electric Power Distribution plc. The energy sector has a critical role to play in decarbonisation, by removing carbon from electricity which in turn will support other sectors. The Company operates solely within the UK which is seeking to achieve net zero by 2050. The UK Government's Net Zero Strategy outlines plans to decarbonise the UK's power system by 2035.

The Company's long-term net zero ambitions are supported by a series of interim targets which are included in the RIIO-ED2 business plan as referenced in the Strategic Report (page 6).

During the year, the wider SSE plc group has continued to make progress against their Net Zero Acceleration Plan and updated their strategy in November 2022 to take account of feedback from shareholders and other stakeholders. The changes involved the inclusion of scope 3 investments to recognise SSE plc's joint acquisition of Triton Power, the addition of cross-cutting issues to recognise the importance that climate adaptation and resilience play in the transition to net zero and further enhancement of the definition of net zero to SSE. As part of the 31 March 23 results, SSE announced a £5.5bn increase to the committed capital pathway through NZAP Plus to further accelerate target delivery. As part of this commitment and in line with the RIIO-ED2 stakeholder led goals, Scottish Hydro Electric Power Distribution plc intend to, alongside its sister company, SEPD, by 2028:

- Reduce the frequency and duration of unplanned power interruptions by 20%;
- Create a foundation for net zero by investing £1bn in strategic resilience across its networks;
- Achieve a customer satisfaction score of 9.2 or more (out of 10) in every customer contact area;
- Support 200,000 customers in vulnerable situations with targeted fuel poverty, personal resilience and energy efficiency measures;
- Facilitate the connection of an additional 1.3 million electric vehicles and 800,000 heat pumps; and
- Reduce its business carbon footprint by at least 35%, aligned to a 1.5c science-based target.

The company has determined that the most significant future impacts from climate change on its operations will be from storm damage network risk through increased severity of extreme weather events. This is explained on pages 8 to 10 in the principal risks and uncertainties, which form part of the "Other information," rather than the audited financial statements. Our procedures on these disclosures therefore consisted solely of considering whether they are materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appear to be materially misstated.

As explained in the Basis of Preparation in note 1, management have considered the impact of climate change when preparing the financial statements. Cash flow forecasts used in the preparation of the financial statements reflect the £18bn investment programme announced by SSE plc in the 31 March 23 results and the potential impact of adverse weather conditions.

Our audit effort in considering climate change was focused on evaluating management's assessment of the impact of climate risk, physical and transition, and ensuring that the effects of material climate risks disclosed on pages 8 to 10 have been appropriately reflected by management in reaching areas of judgement in the financial statements. We also challenged the Directors' considerations of climate change in their assessment of going concern and associated disclosures.

Whilst the company have stated its commitment to the aspirations of the Paris Agreement to achieve net zero emissions by 2050, and also to their acceleration plan of their net zero ambitions which plans a 5 year, 10 year and 30 year roadmap, there may still be some areas in which the company is currently unable to determine the full future economic impact on their business model, operational plans and customers to achieve this and therefore as set out above the potential impacts are incorporated to the extent of management's best estimate at 31 March 2023.

Key audit matters

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

Independent Auditor's Report to the Members of Scottish Hydro Electric Power Distribution plc (*continued*)

Key audit matters (*continued*)

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p>Carrying value of PP&E, specifically the risk around incorrect cost capitalisation (PP&E NBV 2023: £1.647bn, PP&E 2022: £1.508bn)</p> <p>Refer to accounting policies (page 38), and Note 9 of the financial statements (page 46)</p> <p>The PP&E balance in Scottish Hydro Electric Power Distribution plc is quantitatively the most significant. The capitalisation of costs involves a level of judgement and therefore there is a heightened risk of material misstatement in this area.</p> <p>This risk is specifically related to the potential for incorrect capitalisation of costs. The risk is that costs are capitalised that are not capital in nature. Incorrect cost capitalisation could have a significant effect on the carrying value of the Company's network assets on the balance sheet. This could result in overstated assets and income in the year.</p> <p>It is deemed there is a sufficiently high likelihood of misstatement for this to be classified as a key audit matter.</p>	<p>To respond to the risk, we obtained an understanding of the key controls and processes in place over the capitalisation of costs through our walkthrough procedures.</p> <p>The following substantive procedures were performed:</p> <p><i>Additions Testing</i></p> <p>We selected a sample of PP&E additions in the year and agreed the details to third party evidence to confirm:</p> <ul style="list-style-type: none"> - The correct amount was capitalised - The cost was capital in nature - The cost is correct to be capitalised in line with accounting standards <p><i>Assessment of capitalisation of attributable overheads</i></p> <p>We assessed the appropriateness of attributable overheads capitalised within fixed assets through our audit of the on-cost mass allocation model:</p> <ul style="list-style-type: none"> - We confirmed the clerical accuracy of the model through reconciliation to the trial balance; - We performed a recalculation of the model using centrally obtained GL data; - We verified the valuation of overhead expenses through sample testing of administrative expenses and completion of payroll expense testing; <p>We performed analytical review procedures to understand any changes in cost allocation and held meetings with cost centre managers to validate such movements.</p> <p><i>Board Minutes Review</i></p> <p>We read Board Minutes to identify any unusual or challenging projects that were receiving executive level attention and cross checked this to our additions work to corroborate our findings.</p> <p><i>Disclosure Review</i></p> <p>We assessed the appropriateness and adequacy of the disclosures in line with relevant accounting standards. All audit work in relation to this key audit matter was undertaken by the Scottish Hydro Electric Power Distribution plc audit engagement team.</p>	<p>We conclude that the costs capitalised in the year were materially correct as a result of the procedures we performed.</p> <p>We are satisfied with the adequacy of disclosure included in the financial statements</p>

Independent Auditor's Report to the Members of Scottish Hydro Electric Power Distribution plc (*continued*)

Key audit matters (*continued*)

Risk	Our response to the risk	Key observations communicated to those charged with governance
<p>Management override of controls, specifically around revenue recognition (Revenue 2023: £381.3m, Revenue 2022: £384.3m)</p> <p><i>Refer to Accounting policies (page 38); and Note 2 of the Financial Statements (page 43)</i></p> <p>Revenue earned by Scottish Hydro Electric Power Distribution plc mostly relates to billing suppliers for the use of their Networks and new connections to the Network.</p> <p>Revenue recognition is a particular area of focus for our audit. We consider possible areas of management bias and fraud, arising from management override of controls. There is management incentive to post manual credits to revenue to improve Company profitability.</p> <p>There are also instances of manual adjustments to revenue figures, and the accuracy and recording of any such material adjustments may represent a fraud risk of material misstatement to revenue.</p>	<p>To respond to the risk, we obtained an understanding of the key controls and processes in place over revenue recognition and the recording of manual journal entries. We tested selected key IT general controls and performed data analytics procedures.</p> <p>We utilised data analytics techniques to correlate sales through to debtors and subsequently cash. We tested material non-correlating entries to third party evidence to ensure these had been correctly recognised. We also tested a sample of revenue transactions to bank statements to confirm cash receipts.</p> <p>We performed revenue cut-off testing by selecting a sample of transactions pre and post year end and inspecting supporting documentation to verify the period the transaction related to.</p> <p><i>Disclosure Review</i></p> <p>We assessed the appropriateness and adequacy of the disclosures in line with relevant accounting standards. All audit work in relation to this key audit matter was undertaken by the Scottish Hydro Electric Power Distribution plc audit engagement team.</p>	<p>We conclude that revenue recognised in the period is materially correct based on the procedures performed.</p> <p>We are satisfied with the adequacy of disclosure included in the financial statements.</p>

The key audit matters are consistent with the prior year with no changes.

Our application of materiality

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

Materiality

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

We determined materiality for the company to be £2.9 million (2022: £4.4 million), which is 5% (2022: 5%) of profit before tax. We believe that profit before tax provides us with a consistent measure of underlying year-on-year performance.

Independent Auditor's Report to the Members of Scottish Hydro Electric Power Distribution plc (*continued*)

Performance materiality

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

On the basis of our risk assessments, together with our assessment of the company's overall control environment, our judgement was that performance materiality was 50% (2022: 75%) of our planning materiality, namely £1.4m (2022: £3.4m). We have set performance materiality at this percentage due to our assessment of the control environment of the entity including the attitude and integrity of management and those charged with governance. The reason for the percentage change from 2022 to 2023 is a result of change in control environment during 2022 which has since been corrected.

Reporting threshold

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

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.14m (2022: £0.22m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

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

Other information

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

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

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

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

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

Matters on which we are required to report by exception

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

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

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

Independent Auditor's Report to the Members of Scottish Hydro Electric Power Distribution plc (*continued*)

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 24, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

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

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

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

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the company and determined that the most significant are those that relate to the reporting framework (FRS101, Companies Act 2006 and UK Corporate Governance Code), relevant tax compliance regulations in the UK and the Electricity Distribution Licence.
- We understood how Scottish Hydro Electric Power Distribution plc is complying with those frameworks by making enquiries of management and those responsible for legal and compliance procedures. We confirmed our enquiries through our review of board minutes, regulatory correspondence and papers provided to the SSE plc Audit Committee.
- We assessed the susceptibility of the company's financial statements to material misstatement, including how fraud might occur by meeting with management to understand where they considered there was susceptibility to fraud. We also considered performance targets and their propensity to influence on efforts made by management to manage earnings. We considered the programmes and controls that the company has established to address risks identified, or that otherwise prevent, deter and detect fraud; and how senior management monitors those programmes and controls at a group level. Where the risk was considered to be higher, we performed audit procedures to address the identified fraud risk, management override of controls, specifically around revenue recognition.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved: journal entry testing, with a focus on manual journals and journals indicating large or unusual transactions based on our understanding of the business and enquiries of legal counsel and management. In addition, we completed procedures to conclude on the compliance of the disclosures in the financial statements and accounts with all applicable requirements.

We understood the relationship between Scottish Hydro Electric Power Distribution plc and its regulator, the Office of Gas and Electricity Markets (OFGEM), to understand their scope of authorisation and controls the entity has in place to meet their requirements. We requested copies of any correspondence with the regulator that is relevant to our audit and discussed ongoing regulatory matters with the directors.

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

Independent Auditor's Report to the Members of Scottish Hydro Electric Power Distribution plc (*continued*)

Other matters we are required to address

- Following the recommendation from the SSE plc audit committee we were appointed by the company on 18 July 2019 to audit the financial statements for the year ending 31 March 2020 and subsequent financial periods.
- The period of total uninterrupted engagement including previous renewals and reappointments is 4years, covering the years ending 31 March 2020 to 31 March 2023.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the company and we remain independent of the company in conducting the audit.
- The audit opinion is consistent with the additional report to those charged with governance.

Use of our report

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

Ernst & Young LLP.

*Nicola McIntyre (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Glasgow
21 July 2023*

Scottish Hydro Electric Power Distribution plc

Profit and Loss Account for the year ended 31 March 2023

	Note	2023 £m	2022 £m
Revenue	2	381.3	384.3
Other income		-	0.4
Cost of sales		(89.6)	(38.6)
Gross profit		291.7	346.1
Distribution costs		(172.2)	(198.5)
Administrative costs		(22.0)	(21.0)
Exceptional costs	4	-	(20.7)
Operating profit	3	97.5	105.9
Interest receivable and similar income	6	3.9	2.9
Interest payable and similar charges	7	(39.5)	(39.8)
Profit before taxation		61.9	69.0
Tax on profit	8	(13.6)	(40.9)
Profit for the financial year		48.3	28.1

Continuing operations

The above results are derived from continuing activities.

The accompanying notes are an integral part of these Financial Statements.

Scottish Hydro Electric Power Distribution plc

Statement of Other Comprehensive Income for the year ended 31 March 2023

	2023	2022
	£m	£m
Profit for the financial year	48.3	28.1
Other comprehensive income		
Items that will be reclassified subsequently to profit or loss:		
Loss on effective portion of cash flow hedges	(0.1)	-
Other comprehensive loss	(0.1)	-
Total comprehensive income relating to the financial year	48.2	28.1

Scottish Hydro Electric Power Distribution plc

Balance Sheet as at 31 March 2023

	Note	2023 £m	2022 £m
Non-current assets			
Property, plant and equipment	9	1,646.8	1,508.4
Intangible assets	10	34.9	33.9
		1,681.7	1,542.3
Current assets			
Stocks	11	4.6	2.9
Debtors	12	108.2	117.3
Cash and cash equivalents	13	17.5	13.5
Derivative financial assets	20	-	1.2
Total current assets		130.3	134.9
Current liabilities			
Creditors: amounts falling due within one year	14	(186.6)	(169.5)
Net current liabilities		(56.3)	(34.6)
Total assets less current liabilities		1,625.4	1,507.7
Creditors: amounts falling due after more than one year			
Derivative financial liabilities	20	(0.2)	(3.9)
Deferred tax liabilities	17	(127.7)	(117.4)
Net assets		409.9	359.5
Capital and reserves			
Called up share capital	18	62.0	62.0
Profit and loss account		348.6	298.1
Hedge reserve		(0.7)	(0.6)
Equity Shareholders' funds		409.9	359.5

These Financial Statements were approved by the Directors on 18 July 2023 and signed on their behalf by:

DocuSigned by:

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Chris Burchell
 Director
 Company registered number: SC213460

Scottish Hydro Electric Power Distribution plc

Statement of Changes in Equity for the year ended 31 March 2023

	Share capital £m	Retained earnings £m	Hedge reserve £m	Total equity £m
Balance at 1 April 2021	62.0	268.2	(0.6)	329.6
Profit for the year	-	28.1	-	28.1
Total comprehensive income for the year	-	28.1	-	28.1
Credit in respect of employee share awards	-	1.8	-	1.8
Balance at 31 March 2022	62.0	298.1	(0.6)	359.5
Balance at 1 April 2022	62.0	298.1	(0.6)	359.5
Profit for the year	-	48.3	-	48.3
Other comprehensive loss	-	-	(0.1)	(0.1)
Total comprehensive income for the year	-	48.3	(0.1)	48.2
Credit in respect of employee share awards	-	2.2	-	2.2
Balance at 31 March 2023	62.0	348.6	(0.7)	409.9

Scottish Hydro Electric Power Distribution plc

Cash Flow Statement for the year ended 31 March 2023

	Note	2023 £m	2022 £m
Operating profit		97.5	105.9
Depreciation on property, plant and equipment	9	55.6	54.1
Amortisation of intangible assets	10	4.7	3.5
Impairment charges		-	20.7
Movement on operating derivatives		1.2	0.1
Charge in respect of employee share awards	5	2.2	1.8
Customer contributions and capital grants released		(3.2)	(3.2)
Cash generated from operations before working capital movements		158.0	182.9
Increase in debtors		(13.8)	(7.2)
Increase in creditors		29.7	39.0
Movement in intercompany		55.8	(12.4)
Increase in stock		(1.7)	(0.6)
Cash generated from operations		228.0	201.7
Interest paid		(22.0)	(27.3)
Taxes paid		(2.8)	(3.5)
Net cash from operating activities		203.2	170.9
Purchase of property, plant and equipment		(193.0)	(163.6)
Purchase of intangible assets		(5.7)	(6.6)
Net cash used in investing activities		(198.7)	(170.2)
New borrowings	22	-	300.0
Repayment of borrowings	22	(0.5)	(300.6)
Net cash from financing activities		(0.5)	(0.6)
Net Increase/(decrease) in cash and cash equivalents		4.0	0.1
Reconciliation of net cash flow to movement in net funds			
Increase in cash in the year		4.0	0.1
Net cash at start of the year		13.5	13.4
Net cash at end of the year		17.5	13.5

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements for the year ended 31 March 2023

1 Significant accounting policies

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

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

Basis of preparation

The Financial Statements have been prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including Financial Reporting Standard 101 (Reduced Disclosures) ("FRS 101") as issued by the Financial Reporting Council.

In these Financial Statements, the Company has applied the exemptions available under FRS 101 in respect of the following disclosures:

- The effect of new, but not yet effective, IFRSs;
- Related party disclosures; and
- Comparative period reconciliations for property, plant and equipment, intangible assets and share capital.

As the consolidated Financial Statements of SSE plc include the equivalent disclosure, the Company has also taken advantage of the exemptions, under FRS 101, available in respect of the following disclosures:

- Certain disclosures, required by IAS 36 *Impairment of assets*, in respect of the impairment of goodwill and intangible assets;
- Certain disclosures, required by IFRS 13 *Fair Value Measurement* and IFRS 7 *Financial Instruments Disclosure* and IFRS 15 *Revenue from Contracts from Customers*; and
- Certain disclosures, required by IFRS 16 *Leases*.

In preparing the financial statements, the Company has considered the impact of climate change, taking into account the relevant disclosures in the Strategic Report. These considerations included the capital expenditure planned in order to deliver the Group's £18bn 'Net Zero Acceleration Programme PLUS' (NZAP+) by 2027 and the potential impact adverse weather could have on our network infrastructure, particularly when forecasting cashflows, in assessing going concern, assessing useful economic lives and looking for indicators of impairment.

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

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

The Directors consider that the Company has adequate resources to continue in operational existence for the period to 31 December 2024. The Financial Statements are therefore prepared on a going concern basis. In making their assessment, the Directors have considered future cash flows, including sensitivities on future cashflow projections, and the level of headroom on long-term loans and bonds for the period to 31 December 2024.

Additional cash flow modelling, including the impact of periods of reduced demand and stressed conditions on the Company's ability to refinance maturing debt, was carried out against which operational and financial mitigants were also considered. This cash flow modelling displays the potential prospective impact on the financial position of the Company for the foreseeable future, based on plausible downside scenarios which may materialise over the coming period.

The Directors have also considered the arm's length intercompany funding from other companies with the SSE plc Group and the Group's commitment not to request repayment of intergroup funding, unless the company has the reserves to do so for the period to 31 December 2024. In managing the liquidity of the Company, the Directors look to blend intergroup and external debt to create a balance of maturity, term and rate.

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)* for the year ended 31 March 2023

1 Significant accounting policies *(continued)*

Basis of preparation *(continued)*

The Group has provided a letter of support confirming it will provide support to the Company to 31 December 2024, which is at least 12 months from the date of signing of these accounts, where required. The Directors are satisfied that the Group has the ability to provide this support, should it be required. In assessing the financial strength of the letter of support provided, the directors considered the cash and cash equivalents balance of £891.8m at 31 March 2023, and the undrawn committed bank facilities of £2.75bn maintained by the Group. In coming to this conclusion, the Directors have taken into account the Group's credit rating and the successful issuance of £1.6bn of long term funding in the 22/23 financial year being a €1bn NC6 Hybrid at 4% in April 2022, a 7 year €650m Eurobond at a coupon of 2.875% and a £350m dual tranche US Private Placement. As well as taking account of the factors noted, the going concern conclusion is arrived at after applying stress testing sensitivities to the Group's cash flow and funding projections including removal of proceeds from unconfirmed future divestments, negative and positive sensitivities on operating cash flows and uncommitted capex and other adjustments.

The Company has access to £1.75bn of the Group's undrawn committed facilities.

The Company is in a net current liability position of £56.3m as at the financial year end.

Having reviewed the financial strength of the Group, the directors are satisfied that the Group, and the Company itself, will remain funded for foreseeable future. The Directors have therefore concluded it is appropriate for the financial statements to be prepared on a going concern basis.

Revenue

Use of Electricity Networks

Revenue from use of electricity networks is derived from the allowed revenue as defined by the parameters in the relevant electricity distribution licence, which informs the tariffs set.

Electricity distribution revenue recognised is based on the volume of electricity distributed "over time", as use of the distribution service is determined by the customer, and the set customer tariff. Where this revenue differs from the allowed revenue, there may be an over- or under-recovery of revenue which will be reflected in future financial year's allowed revenue as set out in the regulatory licence. No accounting adjustments are therefore made for over- or under-recoveries in the year that they arise as they are contingent on future events (being the distribution of electricity in a future period). The over or under recovery adjustment is recognised in the subsequent period when included within the tariffs that form allowed revenue under the regulatory agreement.

The Company is responsible for recovering industry charges for supplier failures from customers under Ofgem's Supplier of Last Resort scheme. The Company's policy is to recognise revenue for recovered amounts when the Company is entitled to invoice customers through its regulated use of system tariff. The Company recognises its obligation to pay amounts recovered to eligible suppliers when the Company is entitled to invoice customers through its regulated use of system tariff.

Network contracted services

Where the Company has an ongoing obligation to provide contracted services (such as for distribution network connections), revenues are recognised 'over time' consistent with the customer receiving and consuming the benefits of that service across the expected contractual service period. Any assets constructed in order to deliver the service are capitalised and depreciated over their useful life. Payments are typically received from customers in advance of providing the contracted service and are deferred on balance sheet. No extended warranty periods are offered.

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)* for the year ended 31 March 2023

1 Significant accounting policies *(continued)*

Foreign currencies

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

Research

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

Taxation

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

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

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

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

Property, plant and equipment

Property, plant and equipment (PPE) is stated at cost less accumulated depreciation and accumulated impairment losses.

Depreciation is charged to the profit and loss account on a straight line basis over the estimated useful lives of each part of an item of property, plant and equipment and is included within distribution costs in the profit and loss account. Land is not depreciated. The estimated useful lives are as follows:

	Years
Network assets:	
Underground and subsea cables, overhead lines	5 to 80
Non-operational assets:	
Buildings	5 to 80
Fixtures, equipment, plant and machinery, vehicles and mobile plant	5 to 10

Assets held under leasing arrangements are recognised as right-of-use assets and are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

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

Expenditure incurred to replace a component of a property, plant and equipment that is accounted for separately is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits of the PPE to which it relates.

Intangible assets

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

Included within intangible assets are application software license fees, software development work, software upgrades and purchased PC software packages. Amortisation is charged on a straight line basis over 10 years and is included within distribution costs in the profit and loss account.

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)* for the year ended 31 March 2023

1 Significant accounting policies *(continued)*

Capitalised interest

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

Leases

At lease commencement date, the Company recognises a right-of-use-asset and a lease liability on the balance sheet. The right-of-use asset is measured at cost, which is made up of the initial measurement of the lease liability and any lease payments made in advance of the lease commencement date.

The Company depreciates the right-of-use assets on a straight line basis from the lease commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. The Company also assesses the right-of-use asset for impairment when such indicators exist.

At the commencement date, the Company measures the lease liability at the present value of the lease payments unpaid at that date, discounted using the Company's incremental borrowing rate.

Impairment review

The carrying amounts of the Company's PPE and other intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, or where there are indications that a previously recognised impairment loss has reduced. For PPE and other intangible assets that have previously been identified as exhibiting indications of impairment, the review of impairment will be performed annually until there is sufficient evidence to confirm that any potential impairment loss has been appropriately recognised, or until previously recognised impairment losses have been fully written back.

For assets subject to impairment testing, the asset's carrying value is compared to the asset's recoverable amount. The recoverable amount is determined to be the higher of the fair value less costs to sell (FVLCS) and the value-in-use (VIU) of the asset.

If the carrying amount of the asset exceeds its recoverable amount, an impairment charge will be recognised immediately in the profit and loss account. Reversals of previous impairment charges are recognised if the recoverable amount of the asset significantly exceeds the carrying amount.

Customer contributions

Customer and regulatory contributions towards construction are recorded as deferred income and released to the profit and loss account over the estimated life used in calculating contributions. Deferred income includes customer contributions towards new connections, which are released over the estimated useful economic life of the connection asset.

Government grants

Government grants towards Innovation projects are recognised as income over the period necessary to match them with the related costs, for which they are intended to compensate, on a systematic basis. Grants related to income are presented separately as other income in the profit and loss account. Capital grants are recorded as deferred income and released to the profit and loss account over the estimated life of the asset.

Cash and cash equivalents

Cash and cash equivalents represents amounts received from Distribution Network Operators / National Grid in line with annual Ofgem Funding Directions for Innovation projects, and security deposits received from customers in respect of connections projects. The use of Innovation related cash is restricted and can only be used for the purpose of the project. Security deposit cash is ring fenced and held on behalf of National Grid until either returned to the customer on completion of the project or matured in respect of customer cancellation. The balances are not remitted to SSE plc as part of the Group's central treasury operations.

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)* for the year ended 31 March 2023

1 Significant accounting policies *(continued)*

Stocks

Stocks are stated at the lower of cost and net realisable value.

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. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Pensions

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

Equity and equity-related compensation benefits

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

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

The costs associated with the other main employee schemes, the Share Incentive Plan and the Deferred Bonus Scheme, are recognised over the period to which they relate.

Derivative financial instruments and hedging

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

Significant judgements and estimates

There are no significant judgements or estimates in the year.

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)* for the year ended 31 March 2023

2 Analysis of Revenue

An analysis of the Company's revenue by business segment is set out below:

	General use of electricity networks £m	Network connections services £m	Out of area network activity £m	Metering income £m	Other revenue £m	Total £m
Distribution revenue at 31 March 2023	356.3	1.3	6.0	1.2	16.5	381.3
Distribution revenue at 31 March 2022	360.3	4.0	5.0	0.9	14.1	384.3

The existence of each segment is fundamental to the successful operation of the distribution network. Each segment has similar economic characteristics and therefore the Directors assess the Company has one reportable operating segment. The Company generates revenue for the construction, maintenance and renovation of the distribution network in the north of Scotland, responsible for the supply of electricity to over 0.7m homes and businesses. The Company also provides electricity connections providing essential and safe access to the distribution network. Each segment represents an essential element of the network, allowing customers to gain and maintain supply of electricity and therefore the Directors assess that the Company has one reportable operating segment. As such, the Company does not place reliance with any single key customer.

The Company recognised £nil (2022:£0.4m) other income relating to government grants in the year. This does not equate to other revenue denoted in the analysis above.

3 Expenses and auditor's remuneration

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

	2023 £m	2022 £m
Depreciation of property, plant and equipment (note 9)	55.6	54.1
Amortisation of intangible assets (note 10)	4.7	3.5
Lease charges (i)	0.1	0.2
Release of deferred income in relation to customer contributions and capital grants	(3.2)	(3.2)
Government grants related to income	-	(0.4)
Net management fees in respect of services provided by Group companies	17.4	16.5
Research costs	2.3	2.9
Exceptional impairment charges (note 4)	-	20.7

(i) Represents the expense of leases with a duration of 12 months or less, leases deemed to be "low value" and variable lease payments which do not depend on an index or rate with £0.1m (2022: £0.2m) charged in the current year.

The Company incurred £0.2m of external audit fees (2022: £0.1m). Included within this are audit related assurance service fees of £0.02m (2022: £0.02m).

4 Exceptional impairment charges

The Company incurred an exceptional impairment charge on its Network assets of £20.7m in the prior year, in relation to a submarine cable fault at Pentland Firth East. The submarine cable was damaged beyond repair and therefore deemed fully impaired. No exceptional events occurred in the year to 31 March 2023.

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)* for the year ended 31 March 2023

5 Staff costs and numbers	2023	2022
	£m	£m
Staff costs:		
Wages and salaries	63.8	61.6
Social security costs	8.0	7.4
Share based remuneration	2.2	1.8
Pension costs (see note 19)	13.4	12.4
	87.4	83.2
Less charged as capital expenditure	(32.9)	(30.8)
	54.5	52.4

Employee numbers	2023	2022
	Number	Number
Customer facing staff	521	504
Support staff	868	954
Total staff employed at 31 March	1,389	1,458

Average employee numbers	2023	2022
	Number	Number
Customer facing staff	512	500
Support staff	865	944
Total monthly average number of people employed by the Company during the year	1,377	1,444

	2023	2022
	£m	£m
Directors remuneration	8.1	7.0

The total remuneration received by the Directors for qualifying and non-qualifying services including amounts paid and receivable under long term incentive schemes during the year was £8.1m (2022: £7.0m). The total attributable to the highest paid Director is £3.2m (2022: £3.1m). The above value is for 11 Directors (2022: 11), 9 of whom were remunerated via another Group company in the year. A value of services to the Company for these Directors cannot be determined, therefore the above value reflects the remuneration received for services to the SSE Group as a whole.

The aggregate of amounts paid and receivable under long term incentive schemes for Directors is £4.7m (2022: £3.8m), of which £2.2m (2022: £2.1m) is due to the highest paid Director. Total company pension contributions of £0.1m (2022: £0.1m) were made to a money purchase scheme on behalf of the Directors.

9 (2022: 8) Directors exercised share options in the parent's shares during the year.

The highest paid Director exercised and received shares under a long-term incentive scheme in the year.

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)* for the year ended 31 March 2023

5 Staff costs and numbers *(continued)*

	Number of directors	
	2023	2022
Retirement benefits are accruing to the following number of Directors under:		
Defined benefit schemes	2	3

6 Interest receivable and similar income

	2023	2022
	£m	£m
Movement on financing derivatives	3.9	2.9

7 Interest payable and similar charges

	2023	2022
	£m	£m
Interest payable to Group companies	16.1	25.1
Bank loans and overdrafts	23.2	14.3
Interest on lease liabilities	0.2	0.3
Foreign exchange translation	-	0.1
	<u>39.5</u>	<u>39.8</u>

8 Taxation

	2023	2022
	£m	£m
UK corporation tax		
Current tax on income for the period	0.9	3.9
Adjustment in respect of prior periods	2.4	(0.6)
Total current tax charge	<u>3.3</u>	<u>3.3</u>
Deferred tax (see note 17):		
Origination and reversal of temporary differences	10.4	8.9
Adjustment in respect of prior periods	(3.4)	0.5
Effect of change in tax rate	3.3	28.2
Total deferred tax	<u>10.3</u>	<u>37.6</u>
Total tax on profit	<u>13.6</u>	<u>40.9</u>

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements (continued) for the year ended 31 March 2023

8 Taxation (continued)

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

	2023 £m	2022 £m
Profit before taxation	<u>61.9</u>	69.0
Tax on profit at standard UK corporation tax rate of 19% (2022: 19%)	11.8	13.1
Effects of:		
Adjustment in respect of previous periods	(1.0)	(0.1)
Other items	(0.5)	(0.3)
Effect of change in tax rate	<u>3.3</u>	28.2
Total tax charge for year	<u>13.6</u>	<u>40.9</u>

The standard rate of tax applied to reported profit on ordinary activities is 19% (2022: 19%). The Government announced in the Budget on 3 March 2021 that the main rate of corporation tax will increase to 25% for the financial year beginning 1 April 2023. Prior to this date, the rate of corporation tax will remain at 19%. The increase in the rate to 25% was substantively enacted on 24 May 2021, therefore the company has continued to measure deferred tax balances at 25%, this being the rate at which temporary differences are materially expected to unwind in future. The rate change resulted in an increase to the Company's deferred tax liability of £25.4m at 31 March 2022.

Finance Bill 2021 also included draft legislation in respect of Capital Allowance 'Super-deductions' of 130% in respect of General Pool plant and machinery, alongside First Year Allowances of 50% for Special Rate Pool plant and machinery for the two years commencing 1 April 2021. The Company expects these changes, which were substantively enacted on 24 May 2021, to significantly increase the deduction for Capital Allowances in the financial years ending 31 March 2022 and 31 March 2023. An estimate of the super-deduction has been taken into account when calculating the effective tax for the current year and prior year. Finance Bill 2023 introduced draft legislation, effective from 1 April 2023 to 31 March 2026, to allow 'Full Expensing' of 100% General Pool plant and machinery, alongside 50% for Special Rate Pool plant and machinery. The Company expects these changes to significantly increase the deductions for Capital Allowances in the financial years ending 31 March 2024 to 31 March 2026.

9 Property, plant and equipment

	Network assets £m	Assets under the course of construction (AUC) £m	Land and buildings £m	Vehicles and miscellaneous equipment £m	Total £m
Cost:					
At 1 April 2022	2,753.4	36.6	5.5	92.4	2,887.9
Additions	-	194.0	-	-	194.0
Transfers from AUC to fully commissioned	199.0	(203.9)	-	4.9	-
At 31 March 2023	<u>2,952.4</u>	<u>26.7</u>	<u>5.5</u>	<u>97.3</u>	<u>3,081.9</u>
Depreciation:					
At 1 April 2022	(1,293.8)	-	(0.9)	(84.8)	(1,379.5)
Charge for the year	(50.7)	-	(0.3)	(4.6)	(55.6)
At 31 March 2023	<u>(1,344.5)</u>	<u>-</u>	<u>(1.2)</u>	<u>(89.4)</u>	<u>(1,435.1)</u>
Net book value:					
At 31 March 2023	<u>1,607.9</u>	<u>26.7</u>	<u>4.3</u>	<u>7.9</u>	<u>1,646.8</u>
At 31 March 2022	1,459.6	36.6	4.6	7.6	1,508.4

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)* for the year ended 31 March 2023

9 Property, plant and equipment *(continued)*

The above property, plant and equipment includes £1.4m (2022: £1.4m) capitalised interest. No interest was capitalised in either the current or prior year. This is depreciated annually according to the useful economic life of the asset to which the capitalised interest relates.

Included in the above line items are right-of use assets over the following:

	Land and buildings £m
Cost:	
At 1 April 2022	5.5
Additions	-
At 31 March 2023	5.5
Depreciation:	
At 1 April 2022	(0.9)
Charge for the year	(0.3)
At 31 March 2023	(1.2)
Net book value:	
At 31 March 2023	4.3
At 31 March 2022	4.6

10 Intangible assets

	Assets in development £m	IT Software £m	Total £m
Cost:			
At 1 April 2022	12.3	38.2	50.5
Additions	5.7	-	5.7
Transfers to fully commissioned assets	(2.0)	2.0	-
At 31 March 2023	16.0	40.2	56.2
Amortisation:			
At 1 April 2022	-	(16.6)	(16.6)
Charge for the year	-	(4.7)	(4.7)
At 31 March 2023	-	(21.3)	(21.3)
Net book value:			
At 31 March 2023	16.0	18.9	34.9
At 31 March 2022	12.3	21.6	33.9

11 Stocks

	2023 £m	2022 £m
Raw materials and consumables	4.6	2.9

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)* for the year ended 31 March 2023

12 Debtors

	2023	2022
	£m	£m
Trade debtors	17.7	19.8
Prepayments and accrued income	73.7	62.9
Corporation tax debtor	-	0.5
Contract related receivables	8.1	3.0
Amounts owed by Group undertakings	8.7	31.1
	108.2	117.3

Contract related receivables relate to costs incurred on non-capital networks projects. These projects are performed at the customer's request and are paid for in full directly by the customer. The projects are partially completed at the financial year end, the costs being recognised as contract related receivables and the related income received from the customer being held within contract related liabilities at the balance sheet date.

13 Cash and cash equivalents

	2023	2022
	£m	£m
Cash and cash equivalents	17.5	13.5

Cash and cash equivalent consists of amounts received to fund Innovation projects as well as security deposits received from customers in respect of DUOS and Connections activity. Innovation cash is received from DNOs to fund the Resilience at Work (RAAS) Ofgem's Networks Innovation Competition funding. These bank accounts contain amounts received from DNOs / National Grid in line with annual Ofgem Funding Directions. The use of the cash is restricted and can only be used for the purpose of the project. Security deposit cash is held for customer connections projects and is ring fenced. The money is either returned to the customer on completion of the connection or matured in respect of cancellation. The restricted cash balance has not been remitted to SSE plc as part of the Group's central treasury operations. Any non-restricted cash generated by the Company is remitted to or obtained from the Group or SSE Services plc.

14 Creditors: amounts falling due within one year

	2023	2022
	£m	£m
Trade creditors	5.8	6.6
Amounts owed to Group undertakings	115.4	82.0
Other creditors	21.5	23.3
Obligations under leases	0.3	0.3
Accruals	30.8	42.8
Contract related liabilities (i)	12.8	14.5
	186.6	169.5

- (i) Current contract related liabilities include customer contributions of £3.2m (2022: £3.2m). Revenue recognised in the reporting period of £1.9m was included in contract liabilities at the beginning of the period.

The amounts owed to Group undertakings include amounts advanced to the Company by its ultimate parent SSE plc. Interest on these balances is charged at 4.03% (2022: 3.89%).

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)* for the year ended 31 March 2023

15 Creditors: amounts falling due after more than one year

	2023 £m	2022 £m
Loans and borrowings (note 16)	173.1	154.2
Loans due to ultimate parent (note 16)	650.0	650.0
Obligations under leases	5.2	5.5
Contract related liabilities (i)	259.3	217.2
	1,087.6	1,026.9

(i) Non-current contract related liabilities include customer contributions of £33.9m (2022: £36.0m).

The amounts owed to Group undertakings include amounts advanced to the Company by its ultimate parent SSE plc. Interest on these balances is charged at 4.03% (2022: 3.89%).

16 Interest bearing loans and borrowings

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

Analysis of Borrowings

	2023 Weighted Average Interest Rate	2023 Face value £m	2023 Fair value £m	2023 Carrying amount £m	2022 Weighted Average Interest Rate	2022 Face value £m	2022 Fair value £m	2022 Carrying amount £m
Non-current								
2.625% Loan Stock Repayable to SSE plc on 31 March 2026	2.63%	300.0	277.9	300.0	4.63%	300.0	299.5	300.0
Between two and five years		300.0	277.9	300.0		300.0	299.5	300.0
2.125% Loan Stock repayable to SSE plc on 31 March 2036	2.13%	100.0	76.9	100.0	2.13%	100.0	92.2	100.0
2.250% Loan Stock repayable to SSE plc on 29 September 2034	2.25%	250.0	189.5	250.0	2.25%	250.0	222.2	250.0
1.429% Index linked bond repayable on 20 October 2056	2.03%	153.9	140.4	173.1	2.04%	153.9	251.2	154.2
Over five years		503.9	406.8	523.1		503.9	565.6	504.2
Total non-current borrowings		803.9	684.7	823.1		803.9	865.1	804.2
Total borrowings		803.9	684.7	823.1		803.9	865.1	804.2

The effective interest rate is equal to the weighted average interest rate for all borrowings.

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)* for the year ended 31 March 2023

17 Deferred tax liabilities

Deferred tax (assets) and liabilities are attributable to the following:

	Assets		Liabilities		Net	
	2023	2022	2023	2022	2023	2022
	£m	£m	£m	£m	£m	£m
Accelerated capital allowances	-	-	128.0	117.3	128.0	117.3
Other timing differences	(0.3)	(0.2)	-	-	(0.3)	(0.2)
Fair value movement on derivatives	-	-	-	0.3	-	0.3
Net tax liabilities	(0.3)	(0.2)	128.0	117.6	127.7	117.4

	1 April 2022	Recognised	Recognised	31 March 2023
	£m	in income	In equity	
	£m	£m	£m	£m
Movement in deferred tax during the year	117.4	10.3	-	127.7

	1 April 2021	Recognised	Recognised	31 March 2022
	£m	in income	in equity	
	£m	£m	£m	£m
Movement in deferred tax during prior year	79.8	37.6	-	117.4

18 Equity

Share capital

	2023	2022
	£m	£m
Equity:		
Allotted, called up and fully paid:		
62,000,000 ordinary shares of £1.00 each	62.0	62.0

Hedge reserve

The hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedge derivative instruments related to hedged transactions that have not yet occurred.

19 Pensions

6% (2022: 8%) of the Company's employees are members of the Scottish Hydro-Electric Pension Scheme which provides defined benefits based on final pensionable pay. As there is no contractual agreement or stated Group policy for charging the net defined benefit cost of the plan to participating entities, the net defined benefit cost of the pension plan is recognised fully by the sponsoring employer, which is another member of the Group.

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

The Company's share of the total contribution payable to the pension schemes during the year was £13.4m (2022: £12.4m).

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)* for the year ended 31 March 2023

20 Derivatives and financial instruments

The Group's Treasury department is responsible for managing the banking and liquidity requirements of the Company, risk management relating to interest rate and foreign exchange exposures, and for managing the credit risk relating to the banking counterparties with which it transacts. Short term liquidity is reviewed daily by the department while longer term liquidity position is reviewed on a regular basis by the Group Board. The department's operations are governed by policies determined by the Group Board and any breaches of these policies are reported to the Tax and Treasury Committee and the Group's Audit Committee. The Group's policy is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to either the Group or Company's reputation.

The Group holds committed bank facilities of £3.5bn at 31 March 2023 of which £1.75bn could be made available to the Company if required. The Directors have considered sensitivities on future cashflow projections and given the facilities available, including those held at Group and Company level, the Directors have concluded that the Company has sufficient headroom to continue as a going concern.

(i) Currency risk

Exposure to currency rate risk arises in the normal course of the Company's business and derivative financial instruments are entered into to hedge exposure to this risk.

The Company presents its Financial Statements in Sterling but also conducts business in foreign currencies. As a result, it is subject to foreign currency exchange risk arising from exchange rate movements which will be reflected in the Company's transaction costs.

The Company's policy is to use forward contracts to manage its exposures to foreign exchange risk. All such exposures are transactional in nature and relate primarily to procurement contracts. The policy is to seek to hedge 100% of its currency requirements arising under all committed contracts.

(ii) Commodity risk

The Company was exposed to the commodity risk that was associated with forward contract activity in the buying (and selling) of commodities. The risk was derived from the Company's oil option contract which was entered into with the aim of meeting the future demand requirements of its energy supply business. This oil option fully expired in the year.

Throughout the year the Company was exposed to market risk associated with fluctuations in the market price of oil as well as the volumetric risk caused by unplanned changes in the load and output of the portfolio. Short-term exposures will arise from the requirement to match volumes of procured oil with the demand of domestic and business supply customers. This can vary from expectation and result in a requirement to close the contracted positions at unfavourable prices.

The risk management activity is carried out by the Group's Energy Portfolio Management ("EPM") business which manages the exposure to energy commodity price movements on behalf of the Company. The strategy has been to manage all exposures to commodity risk through volumetric limits and to measure the exposure by use of Value at Risk (VaR) models which considers exposures in all commodities. The exposure is subject to financial limits established by the Board and managed by reference to guidance agreed by the Risk Committees. Exposures are reported to the Committees on a monthly basis and to the Board when certain trigger levels are exceeded.

The Company accounting policy is to record the operating derivative at fair value through the profit and loss.

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)* for the year ended 31 March 2023

20 Derivatives and financial instruments *(continued)*

(iii) Interest rate risk

Exposure to interest rate risk arises in the normal course of the Company's business. Interest rate risk derives from the Company's exposure to changes in value of an asset or liability or future cash flows through changes in interest rates. Derivative financial instruments are entered into to hedge exposure to risk. The objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the year are explained below.

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

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

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

(iv) Fair values

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

Summary fair values

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

	2023	2023	2022	2022
	Carrying value	Fair value	Carrying value	Fair value
	£m	£m	£m	£m
Financial Assets				
Trade and intercompany debtors	26.4	26.4	50.9	50.9
Operating derivatives	-	-	1.2	1.2
Financial Liabilities				
Trade and intercompany creditors	121.2	121.2	88.6	88.6
Loans and borrowings	173.1	140.4	154.2	251.2
Loans due to ultimate parent	650.0	544.3	650.0	613.9
Derivative financial liabilities	0.2	0.2	3.9	3.9

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

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)* for the year ended 31 March 2023

20 Derivatives and financial instruments *(continued)*

(iv) Fair values *(continued)*

Financial and operating derivative instruments - disclosure

For disclosure purposes, derivative financial instruments are classified into two categories – operating derivatives and financing derivatives. The Company utilises financing derivatives in the form of interest rate derivatives. Operating derivatives related to energy option contracts for oil stored at the Shetland Gas Terminal, which were all held at fair value through the profit and loss account. Non-hedge accounted contracts are treated as held for trading (MTM). The carrying value is the same as the fair value for all instruments. All balances are stated gross of associated deferred taxation.

Basis of determining fair value

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

21 Capital commitments

	2023 £m	2022 £m
Contracted but not provided for	<u>38.5</u>	<u>45.7</u>

22 Net debt

Reconciliation of movements in financing liabilities

	Financing cash flows				Non-cash movements			At 31 March 2023 £m
	At 31 March 2022 £m	New borrowings £m	Repayment of borrowings £m	Repayment of lease creditor £m	Lease liabilities £m	Re-classification £m	Other £m	
Loan Stock Index Linked Bond	650.0	-	-	-	-	-	-	650.0
	154.2	-	-	-	-	-	18.9	173.1
Total long-term liabilities	804.2	-	-	-	-	-	18.9	823.1
Lease liabilities	5.8	-	-	(0.5)	0.2	-	-	5.5
Total loans and borrowings	810.0	-	-	(0.5)	0.2	-	18.9	828.6

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements *(continued)*
for the year ended 31 March 2023

22 Net debt *(continued)*

	Financing cash flows				Non-cash movements			At 31 March 2022 £m
	At 31 March 2021 £m	New borrowings £m	Repayment of borrowings £m	Repayment of lease creditor £m	Lease liabilities £m	Re-classification £m	Other £m	
Loan Stock	350.0	300.0	-	-	-	-	-	650.0
Index Linked Bond	147.6	-	-	-	-	-	6.6	154.2
Total long-term liabilities	497.6	300.0	-	-	-	-	6.6	804.2
Loan stock	300.0	-	(300.0)	-	-	-	-	-
Total short- term liabilities	300.0	-	(300.0)	-	-	-	-	-
Lease liabilities	6.1	-	-	(0.6)	0.3	-	-	5.8
Total loans and borrowings	803.7	300.0	(300.0)	(0.6)	0.3	-	6.6	810.0

23 Related undertakings

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

Company Name	Relation	Country of incorporation	Registered address (key)	2023 Holding %	2022 Holding %	Principal activity
Electralink Limited	Investment	England and Wales	B	4.89	4.89	Data Transfer Service Operator
Gemserv Limited	Investment	England and Wales	A	-	2.78	Market Design, Governance and Assurance Service Provider
DCUSA Limited	Investment	England and Wales	B	1.69	1.67	Billing Framework Operator
MRA Service Company Limited (i)	Investment	England and Wales	A	-	0.36	Metering Point Administration Services Operator
Smart Energy Code Company Limited	Investment	England and Wales	A	0.33	0.33	Smart Metering Implementation Management

(i) In voluntary liquidation

Scottish Hydro Electric Power Distribution plc

Notes on the Financial Statements (*continued*) for the year ended 31 March 2023

23 Related undertakings (*continued*)

Registered Address Key

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

The Company received a dividend of £0.5m from Gemserv Limited in the year and all shares held have been transferred out.

The Directors have reviewed the recoverability of the carrying value of the remaining investments at 31 March 2023 and are satisfied that the carrying amount is not more than the recoverable amount.

24 Ultimate parent company

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

On 3 April 2023 Scottish and Southern Energy Power Distribution Limited transferred its shareholding in the Company SSEN Distribution Limited (a fellow Group undertaking within the SSE plc Group), from this date SSEN Distribution Limited is the immediate controlling company of the Company.