Western Power Distribution (East Midlands) plc

Regulatory Financial Statements

for the year ended 31 March 2016

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1 Foreword

The main activity of Western Power Distribution (East Midlands) plc ("WPD East Midlands" or the "Company") is the distribution of electricity within its service area of the East Midlands region of England. It is one of twelve licensed distribution network operators ("DNOs") within England and Wales.

Each DNO is a natural monopoly regulated by the Gas and Electricity Markets Authority (known as "Ofgem"). It is therefore subject to control on the prices it can charge. The principal legislation governing the structure of the electricity industry in Great Britain is the Electricity Act 1989, as amended by the Utilities Act 2000 and the Energy Act 2004. This legislation provides for a licence framework in which the operations of the DNOs are regulated, pursuant to which income generated is subject to an allowed revenue regulatory framework that provides economic incentives to minimise operating, capital and financing costs consistent with the DNOs providing an acceptably reliable distribution network and meeting their legal responsibilities. This licence framework is overseen by Ofgem.

Licences which govern DNOs require each DNO to produce regulatory accounts. These comprise two documents:

- Regulatory Financial Statements; and

- Regulatory Reporting Pack ("RRP").

The purpose of the Regulatory Financial Statements is to provide financial information on the same basis as that under the normal financial policies of the DNO. The financial statements themselves are in a similar format to a company's statutory accounts prepared under the Companies Act. This document contains these audited Regulatory Financial Statements.

The RRP is designed to monitor performance against assumptions used in the latest price review, and better inform future price reviews. The level of detail should highlight the cost drivers within a DNO and thus ensure that the regulated allowance fairly reflects this.

2 Strategic Report for the year to 31 March 2016

Business model

What we do
WPD East Midlands is a DNO which distributes electricity to approximately 2.6 million end users over an area of 16,000 square kilometres in the East Midlands of England. What we do is simple and comprises 4 key tasks:

- we operate our network assets effectively to 'keep the lights on';
- we maintain our assets so that they are in a condition to remain reliable;
- we fix our assets if they get damaged or if they are faulty;
- we upgrade the existing networks or build new ones to provide additional electricity supplies or capacity to our customers.

The 2.6 million end users are registered with licensed electricity suppliers, who in turn pay WPD East Midlands for distributing electricity across our network. Our charges are regulated and make up around 16% of a domestic customer's bill.

WPD East Midlands' network comprises approximately 21,461 km of overhead lines, 51,254 km of underground cable and 43,176 transformers.

During 2015/16, the maximum demand recorded was 4,997 megawatts (2014/15: 5,094 megawatts).

Group structure
Western Power Distribution plc ("WPD plc") is the parent of a group ("WPD Group" or "WPD") whose principal activity is undertaken by WPD East Midlands, Western Power Distribution (West Midlands) plc ("WPD West Midlands"), Western Power Distribution (South West) plc ("WPD South West") and Western Power Distribution (South Wales) plc ("WPD South Wales"). Where appropriate the four DNOs share engineering control and other systems.

Regulation
WPD East Midlands is a monopoly regulated by Ofgem. The operations are regulated under the distribution licence which sets the outputs that WPD need to deliver for their customers (or end users) and the associated revenues they are allowed to generate for the eight-year period from 1 April 2015 to 31 March 2023.

The regulatory framework is based on a new approach for sustainable network regulation, known as the "RIIO" model where Revenues=Incentives+Innovation+Outputs. From 1 April 2015 Ofgem set an eight year electricity price control (known as RIIO-ED1). Under the RIIO model there is a much greater emphasis on companies playing a full role in developing a more sustainable energy sector and delivering value for money network services for customers. A key feature of the RIIO model is that the setting of outputs that network companies are expected to deliver will be much more extensive with the outputs embedded within an overall Business Plan which acts as a "contract" between the network companies and their customers.

In July 2013, WPD submitted an outputs based Business Plan for the RIIO-ED1 period 2015-2023. In February 2014 and following a detailed assessment and consultation process, Ofgem announced that WPD’s Business Plan had been accepted as “well justified” and could therefore “fast-track” all four WPD licensed areas, ahead of the other five licensed distributor groups. On 28 March 2014, Ofgem published WPD’s modified licences which took effect from 1 April 2015.

Ofgem set WPD's allowance for the cost of equity at 6.4%, which translates into a weighted average cost of capital ("WACC") allowance of 3.9%, for 2015/16.

Business model (continued)

Regulation (continued)

The charges made for the use of the distribution network are subject to the Retail Price Index ("RPI") where RPI is a measure of inflation. In addition to the base level of revenue WPD East Midlands is allowed to earn, there are incentives to innovate, to achieve customer service outputs relating to customer satisfaction, complaints handling, stakeholder engagement, connections and supply interruptions, and network output measures, which may result in revenue penalties or rewards.

Business objectives

WPD's business objectives are simple. They are:

- to minimise the safety risks associated with WPD's distribution network;
- to improve the reliability of electricity supplies and to make the distribution network more resilient;
- to reduce WPD's impact on the environment and to facilitate low carbon technology;
- to consistently deliver outstanding customer service;
- to meet the needs of vulnerable customers;
- to engage with our stakeholders;
- to be efficient, effective and innovative in everything we do;
- to make a return for the shareholder.

In summary the main objective of the business is to deliver frontier levels of performance at an efficient level of cost.

Long term strategy

WPD's long term strategy is to deliver our business objectives through an efficient and scalable organisational structure that can evolve to accommodate the challenges of the future.

Efficient organisational structure

The current flat organisational structure with locally based teams of in-sourced labour has been the foundation of WPD's success. It gives responsibility to front line staff to deliver work programmes and the absence of multiple layers of management minimises costs.

There are no plans to change this successful business model.

One of the big advantages of the geographical team structure is scalability. More staff can be added to an individual team where increases in future work cluster together or additional teams can be created where there are more widespread increases in workload. These changes can be achieved quickly.

Self-sufficiency

WPD's resourcing strategy is to use in-sourced labour. This ensures that knowledge is retained, allows greater flexibility to redeploy staff where needed and builds a strong culture with staff motivated to deliver business objectives.

The development of in-house apprentice schemes, training facilities, technical knowledge, operational capability and bespoke systems increases the self-sufficiency. This allows the business to respond quickly to new requirements and obligations and have better control over succession planning.

Investment in technology and innovation

Developing better ways of doing things is encouraged throughout the business. Innovative ideas are captured, tested and rolled-out into the business on a regular basis.

Long term strategy (continued)

Investment in technology and innovation (continued)
Technology can provide benefits of improved performance or efficiency. The deployment of technologies is carried out in a way to ensure that compatibility is maintained. This applies equally to IT equipment, communications infrastructure and the roll out of new innovative network management techniques. This keeps costs low as fewer interfaces are required.

Understanding the long term needs of the network
Network monitoring, independent information sources and modelling techniques are used to predict investment requirements into the long term.

Asset replacement forecasts show that in the future more investment will be required to replace an ageing cable population. Monitoring of fault rates and analysis of causes will enable targeted investment programmes to be established. An example of practice where this already exists is in the replacement of Consac cables that were installed in the 1970s but have since been found to have a greater than average fault rate.

The Department for Energy and Climate Change ("DECC") Low Carbon Technology forecasts suggest that there will be extensive requirements for network reinforcement growing exponentially into RIIO-ED2. Smart solutions are being trialled utilising innovation funding to develop lower cost ways of providing network capacity.

Doing more than the legal minimum
As a minimum the activities carried out aim to comply with licence obligations and the Electricity Act. Where identified as being in line with our business objectives, additional activities will be carried out to provide better service or provide additional network capacity.

This approach ensures that our incremental investment above legal requirement is made to bring about clearly identified benefits to our customers, stakeholders and our business.

Completing work programmes
WPD does not delay work programmes. Whilst short term savings could provide a short term financial benefit, such action is not commensurate with providing a longer term reliable network for customers. Unless objectives change, work programmes are completed.

Adapting the network for climate change
We engage with DECC and the industry to identify common climate change impacts and set about implementing changes to ensure that our networks remain reliable into the long term future.

We have used available projected climate data to assess risks resulting from three priority areas - increased lightning activity, flooding and the impact of temperature rise on overhead lines.

Lightning activity is predicted to increase across the whole WPD area. By the end of the RIIO-ED1 period we expect activity to increase by up to 11% in the South West and East Midlands areas. The effects are being mitigated by adding lightning protection devices to the network.

Site specific flood risk assessments are used to identify the most prudent flood prevention method to adopt to protect equipment. Mitigation measures include protection of individual items, protection of buildings, protection of the site as a whole or in extreme cases site relocation.

2 Strategic Report for the year to 31 March 2016

Long term strategy (continued)

Adapting the network for climate change (continued)

Predicted increases in ambient temperature not only mean that thermal expansion will affect overhead line clearances but also thermal loading limits will be reached more quickly. As a result, we have introduced new overhead design requirements to increase ground clearance and have prepared new conductor ratings for overhead lines.

Stakeholder engagement

WPD regularly engage with stakeholders to ensure that our business objectives and strategy are in line with their needs and so that we can learn from our customers first hand. True improvements in customer service and business delivery come from understanding the areas where we can do better.

We use a range of engagement methods, including:

- stakeholder workshops;
- customer panel meetings;
- focus groups with domestic customers;
- 'willingness to pay stated preference' interviews with domestic and business customers;
- connections and distributed generation surgeries;
- distributed generation customer interviews.

Following stakeholder workshops we publish reports detailing all of the feedback received, as well as a WPD response outlining the conclusions we have reached and how this will impact on our plans.

Business review

The focus for the business during the year has been to continue to concentrate on the key five goals of safety, network reliability, customer service, environment and business efficiency.

Key performance indicators ("KPIs")

	2015/16	2014/15
Non-Financial		
Safety:		
Lost time accidents	**2**	1
Non lost time accidents	**17**	22
Network reliability:		
Customer minutes lost	**21.5**	22.9
Customer interruptions (per 100 customers)	**44.5**	46.0
Financial		
Total expenditure*	**£511.0m**	£572.0m
Debt to Regulatory Asset Value ("RAV")	**65.0%**	63.7%
Interest cover**	**5.2**	5.6

* Operating expenses plus capital expenditure (not including customer contributions) on both tangible and intangible assets.

** Interest cover is calculated as interest payable divided by profit before interest, taxation, depreciation and amortisation.

Where applicable the comparative information in the table above has been restated due to the adoption of FRS 101.

Each of the five key goals are discussed in more detail in the following sections.

Business review (continued)

Safety

The safety of our staff, customers and members of the public continues to be a core value at the heart of all our business operations. Maintaining a practical and pragmatic safety culture from the "top down" remains an imperative. WPD staff continue to play an active role in many national committees and steering groups which concentrate on the future of safety and training policies across the industry.

During 2015/16 the Safety Team actively supported WPD Team Managers and Distribution Managers with their safety responsibilities and provided assistance to enable them to maintain a clear focus on safety. The team also continued to provide support to all other areas of the business but with particular focus on the following areas of work:

- The implementation of a programme of behavioural safety workshops for all staff across the whole business to highlight the consequences of personal behaviour and attitudes and the effect these have on their safety performance;
- The development and introduction of a training package to advise staff of the changes implemented by the reissue of the Construction, Design and Management Regulations 2015 to ensure the safety of all staff involved with construction type activities;
- Continued efforts to engage with organisations that work with WPD to achieve safety with the extension of a programme of safety conferences for contractors to encourage sharing of best practices with regards to safe methods of working;
- A review of the procedures associated with the application of earth bonding equipment to distribution network apparatus to ensure safety from induced voltages, with delivery of local briefings to all relevant staff to reinforce safe working methods;
- Work continued with emerging technologies including the iPad to further develop Apps to assist staff with the provision of information and to provide reminders for their safety during their work activities;
- Continued support of the joint initiative between the Electricity Networks Association ("ENA"), Health and Safety Executive ("HSE") and Trades Union bodies under the title of ‘Powering Improvement’ with the 2015 theme being ‘Working with Contractors’.

During the Autumn of 2015 the Safety Team provided a package of presentations in support of the WPD Occupational Health Team, as part of the ‘WPD Safety Week’ programme to highlight issues that affect the health of staff and which also impact on their safety.

In March 2016 a formal internal audit was commenced to confirm that the combined Safety Management Systems conform to OHSAS 18001:2007.

Sadly and regrettably, the safety performance was over-shadowed by one fatality to a member of staff during the year in WPD East Midlands. In addition one member of staff was involved in a lost time accident in WPD East Midlands in 2015/16, compared with one lost time accident in 2014/15. The number of staff involved in non-lost time accidents was 17 in 2015/16, which compares with 22 in 2014/15. The total number of accidents to staff across WPD as a whole increased from 75 in 2014/15 to 80 in 2015/16.

The directors regret this increase in safety incidents; however, they continue to be committed to the highest level of safety in all areas of the business.

Business review (continued)

Network performance

Performance of the distribution network is measured in two key ways:

Security - the number of supply interruptions recorded per 100 connected customers ("CI"); and

Availability - the number of customer minutes lost per connected customer ("CML").

All licensees who operate a distribution system are required to report annually to Ofgem on their performance in maintaining system Security and Availability. The Quality of Service incentive scheme, also known as the Information and Incentives Scheme ("IIS") which was introduced by Ofgem in April 2002, financially incentivises all licensees including WPD with respect to both the Security and Availability of supply delivered to customers.

Network performance reported to Ofgem for the year was as follows:

	Total	Target of less than
Minutes lost per customer 2015/16	22.7	
Excluded event	(1.2)	
IIS Performance 2015/16*	**21.5**	**40.2**
IIS Performance 2014/15*	22.9	67.4
Interruptions per 100 customers 2015/16	44.5	
Excluded event	(1.9)	
IIS Performance 2015/16*	**42.6**	**53.2**
IIS Performance 2014/15*	46.0	75.7

* Subject to Ofgem confirmation of excluded events.

The figures above cover all reportable interruptions longer than three minutes in duration occurring on the WPD East Midlands network including those caused by bad weather and other faults together with 50% of CI and CML due to pre-arranged shutdowns for maintenance and construction. The 11kV network is the principal driver of customer minutes lost, with faults on overhead lines being the major contributor. In addition to the performance reported under IIS above, 89% of customers off supply in the East Midlands as the result of a high voltage ("HV") fault were restored within one hour of the fault occurring.

Under the IIS scheme, performance is targeted at an underlying level of improvement. DNOs are thus permitted to claim an adjustment for events during the year which they believe were exceptional and had a significant impact on the total reported performance. An exceptional event can either be caused by a large number of weather related faults or be due to a one-off event which is outside of the DNO's control. In either case, the event must meet prescribed thresholds in terms of the numbers of faults experienced or, for a one-off event, in terms of either the number of customers affected or the duration of the incident. If an event meets these prescribed thresholds, the DNO must notify Ofgem who will conduct an audit to determine the impact of the event. As part of the audit process the DNO must demonstrate that it mitigated against the impact of the event to the best of its ability before Ofgem will exclude the CI and CML incurred. WPD East Midlands reported two exceptional events to Ofgem during the year.

2 Strategic Report for the year to 31 March 2016

Business review (continued)

Network performance (continued)
Subject to Ofgem confirmation, our IIS CML and CI of 21.5 customer minutes lost and 42.6 interruptions per 100 customers for the year are within our targets of 40.2 and 53.2 respectively. The outperformance relative to the RIIO-ED1 targets set by Ofgem is particularly gratifying as the new targets are particularly tough for a DNO acknowledged by Ofgem as being a frontier performer.

Customer service
We are committed to providing excellent customer service at all times and strongly believe that customer satisfaction is the key to the future success of the business. When dealing with customers our policy is to get it right "first time, every time". On the occasions when we fail to meet this standard, staff are encouraged to take personal responsibility for customer issues, to follow the problem through to the end and to adopt our golden rule - "treat customers the way that we would like to be treated."

If customers are not happy with our efforts to resolve their complaint, they are able to ask The Energy Ombudsman ("Ombudsman") to review the matter. WPD South West and WPD South Wales have completed a seventh year of the statutory Energy Ombudsman Scheme with zero customer complaints upheld. WPD East Midlands and WPD West Midlands achieved a fourth year of the statutory Energy Ombudsman Scheme with zero customer complaints upheld. WPD South West and WPD South Wales are the only DNOs to have zero complaints referred to the Ombudsmand during the first seven years of operation of the statutory scheme.

WPD East Midlands during the year recorded three failures against Ofgem's national Customer Guarantee Service Standards for network performance, and four failures for the year against the 37 standards relating to connections performance. We also exceeded all of our network performance targets under the Quality of Service incentive scheme.

<u>Stakeholder Engagement Incentive</u>
WPD has been rated as the top performing DNO group in the Stakeholder Engagement Incentive Award Scheme (which is a key element of Ofgem's new Broad Measure of Customer Satisfaction), since its introduction in 2011/12. Most recently in 2014/15 WPD was again rated first place and was awarded our highest score ever of 8.75 out of 10. WPD was the only DNO group to show improvement from the previous year. WPD entered two written submissions, followed by a question and answer session with an Ofgem-appointed judging panel of experts.

<u>Broad Measure of Customer Satisfaction</u>
As part of Ofgem’s Broad Measure of Customer Satisfaction Incentive, a research agency undertakes a monthly satisfaction survey of DNO customers who contact their DNO to report loss of supply, have been notified of a planned interruption, have a general enquiry or request a new connection (quoted and completed). This incentive has continued into the RIIO-ED1 period scored across the six performance areas. Each licence area has around 350 customers surveyed per month, so for WPD’s four licence areas around 16,800 customers are surveyed per year. For the regulatory year 2015/16, WPD's four areas achieved average satisfaction scores of between 8.84 and 8.98 out of ten across the six measures.

Ofgem also compare the speed of response that a DNO call centre provides and WPD are consistently identified as the top performer with an average speed of response below 1.6 seconds.

<u>National Customer Service Excellence Standard</u>
WPD's excellent customer service is demonstrated by its continued accreditation to the national Customer Service Excellence Standard.

Business review (continued)

Customer service (continued)

National Customer Service Excellence Standard (continued)
WPD undergo a stringent external assessment of our engagement activities every year. The Customer Service Excellence Standard seeks to ensure we are providing services that are efficient, effective, equitable and have the customer at the heart of everything we do. There is a strong focus on the quality of our engagement methods and in particular the steps we take to develop customer insight, understand users' experiences, robustly capture their feedback and measure satisfaction. The standard assesses WPD's delivery, timeliness, information, professionalism and staff attitudes.

WPD have held the charter mark of best practice since 1992 - the only energy company in the UK to do so. WPD are assessed against 57 elements and have full compliance against every one. As an established holder of the charter mark, WPD are assessed as part of a three year rolling programme, where one third of the standards are reviewed annually. There are four potential outcomes ranging from 'non-compliance' to 'compliance plus' (the highest level possible, indicating best practice across all sectors).

In April 2015 WPD were successfully reaccredited, and demonstrated that significant improvement had again been made by maintaining compliance plus ratings against 21 elements, and a further 8 elements have been identified as reaching this level to bring the total to 29. There were zero partial or non-compliances. During the April 2015 audit, the assessor commended WPD for the introduction of a single contact telephone number publicised by the distribution of 7.8 million fridge magnets, the development of a social obligations programme, facilitating a significant increase in distributed generation and the successful introduction of 24 hour twitter, webchat and facebook access channels.

British Standard for Inclusive Service Provision
In 2014, WPD became the first company in the UK to be externally assessed as fully compliant with the BS18477:2010 British Standard for inclusive service provision. Following an annual audit in March 2016, we retained full compliance with this standard for a third year. BS18477 was recommended by Ofgem as part of their Vulnerable Customer Strategy review discussions. The assessment adds considerable endorsement to WPD's social obligations programme and the services we offer to our Priority Service Register customers. WPD was assessed during a two day audit to review the accessibility of our services, literature and website, as well as WPD's social obligations programme and vulnerable customer strategy, all associated systems and processes, Contact Centre operations and the new connections process. WPD was assessed as fully compliant in over 36 audit elements.

In March 2016 the auditor reported: "The senior management continue to demonstrate a high level of commitment to the standard with consumer vulnerability a key part of their core strategy. A culture of ownership and continual improvement is promoted at all levels of the organisation, which was consistently demonstrated throughout the audit. This is a forward looking organisation which is constantly striving to improve the consumer experience through regular consultation with an expanding network of stakeholders and responding quickly to any opportunity. Social obligations are embedded in the business and are a topic that is consistently high on the agenda. The staff interviewed during the audit consistently demonstrated an innate understanding of the requirements of the standard and also a wider understanding of the needs of vulnerable customers. It was clear that improvement is being built on a solid foundation of good practice with a constant review cycle in place driving both organic and innovative improvements. This includes anticipation of areas to improve through innovative thinking."

Business review (continued)

Customer service (continued)

Customer Panel and Stakeholder Workshops
The WPD Customer Panel was introduced in 2011. The panel meets four times a year and members, who represent a wide range of customers and key stakeholder groups, help us keep up to speed with the issues affecting our customers. Members include representatives from the British Red Cross, Major Energy Users Council, local parish councils, Sainsbury's, B&Q, Energy Saving Trust, Severn Trent Water and National Grid. Through the Panel, we proactively seek honest and challenging customer views about the way we operate and our future plans. It plays an important role in helping WPD develop its business plans and outputs for the RIIO price control. The Panel is attended by WPD's Chief Executive and other senior managers, demonstrating the commitment at every level to proactively engage with customers.

In January 2016 WPD hosted its latest round of annual stakeholder workshops in various locations including Birmingham, Derby, Lincoln, Newport, Bristol and Plymouth. The six events were attended by 259 stakeholders from a range of different backgrounds including domestic, business, local authorities, developers/connections, environmental, energy/utility, regulatory/government and voluntary sectors. WPD have subsequently identified 27 improvement actions that WPD will be taking in order to address the stakeholder feedback received.

Since 2010 WPD has held a number of stakeholder workshops and more than 4,500 people have been engaged to help us build our Business Plan - the vast majority face-to-face. Now that WPD's Business Plan has been agreed, WPD has maintained its relationship with stakeholders and shifted the focus on to delivery and also identifying long-term strategic priorities that may change the way networks operate in the future.

Deaf Awareness Chartermark
WPD holds the Action on Hearing Loss (formerly RNID) 'Louder Than Words' chartermark accreditation, which assesses and endorses the accessibility of WPD's services for deaf and hard of hearing people. We are the only DNO group to have held the accreditation for 6 and 8 years respectively for WPD South Wales/WPD South West and WPD East Midlands/WPD West Midlands.

Environment
WPD is an ISO14001 certified company and is committed to conducting its business as a responsible steward of the environment. WPD plan new routes so as to minimise, as far as economically possible, their impact on the environment.

Every member of staff is made aware of WPD's environmental commitment to abide by environmental laws, regulations and corporate environmental policies, and their responsibilities for reporting any concerns on potential environmental compliance issues so that appropriate action can be taken.

In December 2015 WPD achieved certification to ISO55001, the international standard for Asset Management. ISO55001 is the successor to PAS55, against which WPD has held continuous accreditation since 2006. Whilst asset management specifications, both PAS55 and ISO55001 encompasses risk management, setting of and adherence to policies and procedures, and thus has relevance to control of environmental risk.

Business review (continued)

Fluid filled cables

The design of very high voltage underground cables has evolved over many years and our new cables all use a solid plastic like insulation. Old designs of 33kV and higher voltage cables used an insulating oil in ducts inside the cable. Whilst these cables are normally very reliable, in the event of a fault, or commonly damage by third parties digging the street, this oil may leak out, sometimes many hundreds of litres. In common with other DNOs, WPD works to an operating code agreed with the Environment Agency, and assesses both the condition and the environmental risk posed by the 214 km of fluid filled cables which WPD owns. The losses from WPD's fluid filled cables can vary from year to year dependent on the number of small leaks at disparate locations rather than high volume single events, often caused by third parties.

	Fluid losses (litres) WPD Group
2015/16	19,580
2014/15	25,131
2013/14	16,061
2012/13	39,123

The use of Perfluorocarbon Trace ("PFT") technology within WPD reduces the effect on the total annual fluid losses. WPD provides the Environment Agency with a monthly leak report as required under the joint agreement between the Environment Agency and Energy Networks ("ENA") Fluid Filled Cables Group. A single major leak in the East Midlands accounted for over 10,000 litres in the 2012/13 data.

SF6 gas

Sulphur hexafluoride (SF6) is a man-made gas which has had widespread use such as in double glazing, tennis balls and training shoes as well as a number of industrial applications including high voltage switchgear. Unfortunately it is also a strong greenhouse gas, with a global warming potential 23,900 times greater than carbon dioxide (CO2).

WPD carefully monitors its SF6 equipment and employs the external ENA Engineering Recommendation S38 methodology for the reporting of SF6 banks, emissions and recoveries. That ENA document, initially drafted by WPD, employs approaches set out by The Intergovernmental Panel on Climate Change ("IPCC"), set up by the World Meteorological Organisation and the United Nations Environmental Programme.

The losses from both WPD East Midlands and WPD West Midlands from SF6 equipment in 2015/16 amounted to 128kg representing 0.3% of its bank.

WPD has been listed in the Fluorinated Greenhouse Gas Regulation 2009 as a Recognised Certification and Evaluation Body (HV Switchgear) under Regulation 33, and has now certified relevant WPD staff.

Business review (continued)

Environment (continued)

Electric and magnetic fields ("EMFs")
Concerns have been expressed by some members of the public regarding potential health effects of power frequency EMFs, which are emitted by all devices carrying electricity, including electric transmission and distribution lines and substation equipment. Government officials in the US and the UK have reviewed this issue. The US National Institute of Environmental Health Sciences concluded in 2002 that, for most health outcomes, there is no evidence of EMFs causing adverse effects. The agency further noted that there is some epidemiological evidence of an association with childhood leukaemia, but that this evidence is difficult to interpret without supporting laboratory evidence. The UK National Radiological Protection Board (part of the UK Health Protection Agency) concluded in 2004 that, while the research on EMFs does not provide a basis to find that EMFs cause any illness, there is a basis to consider precautionary measures beyond existing exposure guidelines.

SAGE (Stakeholder Advisory Group on Extremely Low Frequency EMF), a group set up by the UK Government, has issued two reports, one in April 2007 and another in June 2010, describing options for reducing public exposure to EMF. The UK Government agreed to implement some of the recommendations within the first report, including applying optimal phasing to dual circuit transmission lines to reduce EMF emissions, where this can be carried out at low cost. The UK Government is currently considering the second SAGE report which concentrates on EMF exposure from distribution systems.

PPL Corporation and its subsidiaries, including WPD, believe the current efforts to determine whether EMFs cause adverse health effects should continue and are taking steps to reduce EMFs, where practical, in the design of new transmission and distribution facilities.

General
During the year, WPD East Midlands continued to retain it's certification to ISO14001 - Environmental Management Systems. Two six monthly surveillance audits were undertaken in the 12 month period and no major non-conformances were raised.

WPD provides support to communities across the network area with the aim of encouraging energy conservation, promoting recycling initiatives and enhancing the landscape for wildlife. 'Keen to be Green' is the umbrella brand of community environmental activities and enables a range of groups, charities and schools to benefit from cash awarded by WPD. As part of this scheme, WPD plant in the region of 7,000 native trees annually across our network area.

WPD also work with a range of nationally recognised charities including the Centre for Sustainable Energy, The Wildlife Trusts, The Conservation Volunteers and Silvanus Trust.

Business efficiency
Profit before tax decreased by £15.9m compared to the previous year. Operating profit at £271.9m was £15.9m lower with turnover down by £18.0m and operating expenses down by £2.1m. Turnover was impacted by a decrease in tariffs from the start of RIIO-ED1 and the timing of the recovery of regulated income.

Total expenditure ('totex') has decreased by £61.0m. Capital expenditure has decreased by £58.9m. Totex is a key feature in the business plan submission to Ofgem as part of the price review process as it underpins the allowed revenue set; thus actual performance against the business plan is subject to close scrutiny as we are incentivised to stay within the business plan.

Business review (continued)

Business efficiency (continued)

Total net assets at 31 March 2016 were £1,066.9m, an increase of £236.0m on the previous year. Tangible fixed assets increased by £251.4m reflecting the fact that capital expenditure far exceeds the historical cost depreciation charge. Creditors due after more than one year have increased by £116.6m, due to an increase of £56.5m in deferred contributions and a bond issue of £40.0m at a premium of £18.0m.

The Company has also issued £30.0m share capital during the year.

The pension liability decreased from £147.5m to £26.6m. This is largely due to a change in the financial assumptions underlying the calculation of scheme liabilities. In particular, a rise in the yield of AA-rated corporate bonds used to determine the discount rate and an update to salary increase expectations have led to a lower value being placed on the liabilities at the year end. In addition, changes to the demographic assumptions, including an update to the mortality assumption reflecting current trends, further reduced scheme liabilities. The reductions to scheme liabilities are partly offset by an underperformance of asset returns compared to the discount rate. This was mainly a result of lower returns on the scheme's equity holdings.

<u>Debt to RAV</u>

Asset cover (total net debt to regulatory asset value) is part of the rolling credit facility covenants for several of the WPD companies and is used as a key internal measure. As part of the regulatory process, Ofgem determine what they consider an appropriate debt/equity split to optimise the cost of capital and to ensure that the volume of debt in relation to RAV does not threaten the liquidity of the licensee.

<u>Interest cover</u>

The ratio of earnings before interest, tax, depreciation and amortisation (EBITDA) to interest payable is part of the rolling credit facility covenants for several of the WPD companies. It is also used as a key internal measure of the financial health of the DNOs. The interest cover ratio for WPD East Midlands is at an acceptable level and shows that the Company is generating more than enough profits to cover the interest payments.

Capital investment

Gross capital investment (before customers' contributions) during the year was £330.7m across the WPD East Midlands region and included the replacement of overhead lines and switchgear together with the introduction of new technology.

A number of significant projects were undertaken during the year including:

- **Derby Rolls Royce/Velodrome**
  Work was completed on a major project to replace 1.2km of tower line with underground cable. The tower line consisted of seven 22 metre steel towers and a number of wood pole terminal positions. The circuit supplies approximately 5,000 customers including businesses such as a Rolls Royce site and Derby City’s new velodrome. Rolls Royce also required an upgrade in their capacity so the replacement and connection work was undertaken at the same time to minimise disruption. The project was particularly challenging as it was near the Elvaston Castle Nature Reserve, so the scheme needed to take into account issues such as a bat roost and an otter population. Additional challenges were encountered with contaminated land on part of the route but the team addressed these issues and it was completed on time, providing the increased capacity to Rolls Royce and improving the views near to the Nature Reserve.

Business review (continued)

Capital investment (continued)

- **Northampton University**
  The primary substation supplying over 14,000 customers in the Northampton area was contained within an old power station site. Northampton University wished to develop the area for a new campus and a complex project was agreed that involved swapping an area of land for WPD to build a new site and then handing over the old site to the developer of the University. The developer for the University was working to a challenging timescale so it was essential that WPD completed its work on time. On target in May, the work was completed with the installation of two new primary transformers, a 20 way 11kV board and over 11km of 11kV cable installed to connect the new site to the circuits from the old site.

Transition to FRS 101

The Company has transitioned to FRS 101 from previously extant UK Generally Accepted Accounting Practice for all periods presented. Transitional tables showing all material adjustments are disclosed in Note 25.

The impact of all the transition adjustments on the profit for the year to 31 March 2015 was an increase of £17.1m and a reduction in net assets of £247.7m.

Future developments

See page 3 for details of our long term strategy.

RIIO-ED1

All four WPD DNOs were fast-tracked by Ofgem in respect of RIIO-ED1, the only DNOs selected for this process. Fast tracking affords several benefits, including the ability to collect additional revenue equivalent to 2.5% of total annual expenditures (approximately £25m per year across WPD), greater revenue certainty and a higher level of cost saving retention.

Future Networks - Research, Innovation and Low Carbon Networks

As part of the previous distribution price control period (known as DPCR5), Ofgem introduced the Low Carbon Network ("LCN") Fund. It was set up to encourage DNOs to test new technology and commercial arrangements to support the UK's low carbon transition and climate change objectives.

The LCN Fund, totalling £500m over the period 2010-2015, was made available through an annual Ofgem led competition for "flagship" demonstration projects (termed "Tier 2" projects). There was also an annual allowance allocated to each DNO (called "Tier 1" with £21m over the five years for WPD) to enable smaller demonstration projects to be developed with less regulatory oversight.

From April 2015 the RIIO-ED1 arrangements differ from those in DPCR5. These broadly replicate the structure of the LCN Fund. Tier 1 projects have transitioned to the new Network Innovation Allowance ("NIA") regulatory mechanism to fund smaller innovation projects that can deliver benefits to customers as part of a RIIO-Network Licensees price control settlement. The Tier 2 competition has been replaced with the new Network Innovation Competition ("NIC"), an annual competition to fund selected flagship innovative projects that could deliver low carbon and environmental benefits to customers.

WPD has secured funding for six Tier 2 flagship projects under the DPCR5 arrangement, worth approximately £65m, more than any other DNO group, making WPD a clear leader in network innovation.

Future developments (continued)

Future Networks - Research, Innovation and Low Carbon Networks (continued)

The first of these projects, Network Templates, was completed during 2013 with significant new learning which will lead to technical policy changes. The Lincolnshire Low Carbon Hub was completed in February 2015 and resulted in 48MVA of additional capacity being released to new generation customers. Project FALCON completed in October 2015; learning from this project includes more detailed understanding of the application of various engineering techniques, an evolving roadmap about data requirements in the new world and a number of follow on projects that build on the learning from FALCON in key areas such as demand side response, asset rating and data. The SoLa Bristol project was completed in April 2016 and has provided learning linking customer profiles, time of use tariffs and charging/discharging regimes that will inform regulation and tariff changes moving forward.

The six Tier 2 projects are:

- 2011 - Network Templates for a Low Carbon Future - Based on LV data collected from the most extensively monitored distributed network in Europe (800 substations in South Wales and a further 3,600 network monitors in customer premises), the project has developed a new suite of customer consumption profiles that will enable us to improve our utilisation of network assets without impacting customer supply security. We also identified that about 20% more solar panels can be connected to the grid than previously estimated. Further we have identified potential to better exploit the allowed voltage variation around the nominal 230V supply.
- 2011 - The Lincolnshire Low Carbon Hub - The project built a 33kV renewable generation ready "hub" across a large part of the East Midlands coastal region. After several technical network design challenges and a shift in government policy towards onshore wind, the project completed in February 2015. A number of commercial offers for customer generation connections have been issued using newly developed policies and charging methodologies.
- 2012 - Flexible and Low Carbon Optimised Networks ("FALCON") - The project developed a fully interactive 11kV power flow nodal model for the city of Milton Keynes. The model (called a "SIM" - Scenario Investment Model) was populated with data on the real time state of the local grid, together with feedback from a suite of smarter grid demonstration techniques across the city. It will allow DNOs to automatically develop optimised investment plans based on a range of future energy scenarios. Data from the completed engineering trials was used to further build upon and improve the performance of the SIM. Those results were shared at the final dissemination event in 2015.
- 2012 - SoLa BRISTOL - The project demonstrated the concept of coordinating disparate energy controllers located at customer premises to maintain substations within capacity. The project provided valuable control logic for future despatch and control of virtual power plants and electric vehicle charging. In this project the remote energy was stored in battery systems, charged from PV (photovoltaic solar panel) systems on customer roofs. The project also included the conversion of some customer internal systems from alternating to direct current (AC to DC) to improve energy efficiency. The final report stated that although there was a benefit seen on the LV Network, it would require around 60%-70% penetration on a substation to provide significant demand reduction to justify the investment. Coupled with the high level of customer engagement required it is unlikely that a DNO will adopt such a solution.

Future developments (continued)

Future Networks - Research, Innovation and Low Carbon Networks (continued)

- 2013 - FlexDGrid - The transition of the UK energy system from one of centralised energy generation, to one where distributed generation plays a greater role, is leading to new network challenges. In particular the introduction of CHP (combined heat and power) in urban environments is leading to a significant increase in electrical short circuit potential currents (called the "Fault Level"). This project is demonstrating innovative means of modelling, measuring and controlling fault current (short circuit current) in 10 primary substations serving the central business district of Birmingham, Britain's second largest city. The project has completed a significant element of the 'build' phase throughout 2015 and will be completed during 2016.
- 2015 – Network Equilibrium – This project will investigate the problems associated with further demand and generation integration on rural networks through a better understanding of voltage profiles and power flows. Through optimising voltage profiles at a system level and balancing power flows through the innovative use of power electronics, the existing network capacity can be fully utilised allowing an increased level of distributed generation and demand to connect to the existing network more quickly and cost effectively. Three methods will be trialled through the project: Enhanced Voltage Assessment (EVA), System Voltage Optimisation (SVO) and Flexible Power Links (FPL). The project commenced in early 2015. The design documents for the 3 methods were completed in January, February and March 2016. The procurement process is completed and contract negotiations are well under way. Detailed designs are under way and will continue through 2016.

WPD completed 10 projects under DPCR5's Tier 1. Under the new RIIO-ED1 arrangements post April 2015, WPD has registered 16 projects under NIA covering a broad range of topics, including such themes as wireless charging of electric vehicles and supporting community based energy initiatives.

Principal risks and uncertainties

The Company views the following risk categories as those that are the most significant in relation to WPD.

Regulatory risk

The substantial part of the Company's revenue is regulated and is subject to review every eight years. The current price control, RIIO-ED1, commenced 1 April 2015 and continues to 31 March 2023.

Under the review, Ofgem assesses the revenue and capital expenditure plans of the Company and determines what they consider an efficient level of that expenditure. Ofgem also considers the required cost of capital sufficient to encourage the required investment in the network, and determines customer service targets.

WPD's management invests considerable resource in the review process and has been proactive in working with Ofgem to establish better measures of cost recording to inform future reviews.

If the Company feels that, as a result of a review it would financially be unable to continue to operate and to meet its obligations under the licence, then it has the right to refer the matter to the UK Competition and Markets Authority for a determination.

The Company's regulated income and also the RAV are to some extent linked to the movements in RPI. Reductions in RPI would adversely impact revenues and the debt/RAV ratio.

Principal risks and uncertainties (continued)

Network disruption
Disruption to the network could reduce profitability both directly through the lower units delivered on which income is charged, and also through the system of penalties and rewards that Ofgem has in place relating to customer service levels (discussed under the 'Network performance' section).

There are economic restrictions on the level of capital expenditure that can be incurred to make the network totally reliable. A certain level of risk must be accepted and this is recognised by Ofgem in its regulatory review. However, the Company believes that its network is robust. It targets capital expenditure on schemes which are assessed to have the greatest improvement to customer service levels. It also spends considerable sums on routine maintenance, including tree cutting to keep trees away from lines both for safety reasons and as trees have been proven to be a major cause of network interruptions. The Company has met Ofgem's targets for customer service.

Reliance on suppliers
WPD relies on a limited number of suppliers for cable laying and tree cutting services, and for the supply of cables, plant and machinery. However, WPD considers that there are sufficient alternative suppliers such that, should an existing supplier be unable to continue to make supplies, then there will be no significant long-term impact on WPD's ability to operate the network.

Most of the electricity which enters WPD's network is carried on the national grid and enters WPD's network at a limited number of grid supply points. WPD is dependent on the national grid. However, this is also an activity regulated by Ofgem and thus the risk of a major failure is considered very remote.

Environment
Certain environmental issues are discussed in the Corporate and Social Responsibility section. There is always the risk that changes in legislation relating to environmental and other matters, including those imposed on the UK by the European Union, could result in considerable costs being incurred by the Company with no guarantee that Ofgem would allow them to be recovered through regulated income.

Interest rate risk
The Company has had both short-term and long-term external debt during the year, at floating and fixed rates of interest, respectively. An element of the long-term debt is index linked which creates a natural hedge against the Company's regulated income, which is also index linked.

Credit rate risk
WPD South West, WPD South Wales, WPD East Midlands and WPD West Midlands are required by their distribution licences to maintain investment grade ratings, which they have done. All four have the following long-term corporate credit ratings: Moody's Baa1 and Standard & Poor's A-.

Cash deposits are made with third parties with a high credit rating (not below a long-term rating of A/A2/A and a short-term rating of A1/P1/F1 by Standard & Poor's, Moody's and Fitch, respectively) and within strict limits imposed by the appropriate Board.

Creditworthiness of customers
Most of WPD's income is for the delivery of electricity to end-users and thus its customers are the suppliers to those end-users. It is a requirement that all licensed electricity distributors and suppliers become parties to the Distribution Connection and Use of System Agreement. This agreement sets out how creditworthiness will be determined and, as a result, whether the supplier needs to provide collateral. The risk of a significant bad debt is thus considered low.

Principal risks and uncertainties (continued)

Pensions

Most employees are members of a defined benefit pension scheme, which also has a considerable number of members who are either retired or have deferred benefits. There are risks associated with the financial performance of the assets within the scheme and with the estimate of the liabilities of the scheme including longevity of members. Currently, ongoing service costs and a proportion of the deficit costs are recoverable through regulated income.

The defined benefit pension schemes operated by WPD are, with very limited exception, closed to new members. A defined contribution scheme is being offered to new employees instead. As time elapses, this will reduce WPD's exposure associated with defined benefit pension plans.

Insurance arrangements

WPD has a wholly-owned captive insurance company, Aztec Insurance Limited ("Aztec"), based in Guernsey. Depending on the nature of the risk, WPD East Midlands carries all or an element of the risk itself ("self insured") or it underwrites insurance with a combination of Aztec and external insurers.

Insurance arrangements for the year ending 31 March 2016 relating to WPD's key risks were as follows:

- the distribution network is self insured.
- offices and depots including their contents and stock are self insured up to £500,000 for each claim and externally insured above that, subject to a maximum of £50.0m.
- combined liability covers employer's liability, public and product liability, and professional indemnity. The first £10,000 of each claim is self insured, Aztec cover the next part of the claim up to £1.0m per claim and £6.0m in total; claims exceeding these limits are externally insured subject to certain limits.
- on motor related claims, damage to own vehicles is self insured if not recoverable from a third party, as is the first £5,000 of each third party claim. Aztec cover the next part of the claim up to £1.0m for any claim and £2.3m in aggregate; claims exceeding these limits are externally insured subject to certain limits.
- claims relating to death or injury to employees whilst on WPD business or travelling on business are externally insured subject to various limits.
- external insurance is also in place (subject to limits) for loss of money, securities or property through dishonest acts by employees and for wrongful acts by pension scheme trustees.
- insurance in respect of directors and officers is maintained by WPD's US parent, PPL Corporation.
- external insurance is also in place (subject to limits) for cyber liability (costs for security/privacy breaches, defence costs in relation to regulatory breaches and other breaches) and is maintained by WPD's US parent, PPL Corporation.

Insurance arrangements are reviewed in detail annually.

Corporate and social responsibility

Social and community issues

The three themes of education, safety and the environment continue to form the bedrock of our support activity, and during 2015/16 we assisted over 250 separate charitable and non-charitable organisations as part of an investment of over £200,000.

2 Strategic Report for the year to 31 March 2016

Corporate and social responsibility (continued)

Social and community issues (continued)

While maintaining these core themes, we have also continued to tailor our support to align, where appropriate, with the feedback from our stakeholder and customer opinion research.

In particular, we have sought to establish and develop customer initiatives – like our Community Chest partnership with the Centre for Sustainable Energy ("CSE") – which helps not-for-profit and community organisations reduce their energy consumption. Over the last three years, we have injected £134,000 into the initiative enabling over 250 tonnes of carbon dioxide to be saved – equal to the heating and electricity CO_2 emissions from 50 average households.

We have also continued to promote WPD's Priority Service Register ("PSR"), distributing over 5,000 Power Cut Advice and PSR leaflets at a range of events and working with organisations like Age UK, Care & Repair, Wales Council for the Blind, Age Cymru, Gloucester Deaf Association, Hospice organisations in Worcester and Chesterfield, Stoke Macmillan, the Warm Homes Initiative at Dudley, and Deafblind Cymru.

We also continued to back Age Cymru's Doorstep Crime and Spread the Warmth initiatives which target vulnerable and 'fuel poor' customers.

Highlights during the year have included:

- Initiated major community safety campaign Think Safe, Stay Safe aimed at farmers, leisure operators and land owners. During June and July 2015, we communicated important messages with land owners and land users about keeping safe near overhead lines and other electrical infrastructure. Leaflets were distributed to leisure parks and farming/agricultural organisations sign-posting the range of safety posters and literature that can be freely downloaded from the WPD website. Social media, targeted paid-for advertising and media releases helped us reach an estimated 250,000 landowners/users.
- Partnered nine regional Wildlife Trusts across our network to engage children in terms of environmental education. Around 1,500 families and children benefited. We also continue to provide native trees and shrubs as part of our community tree planting initiative, and have expanded this to include orchards following feedback from our conservation partners.
- Supported a range of major business and community initiatives including the Welsh Government's St David Awards, the Cornwall Community Awards, the Wales Business Awards, Mansfield Big Snore initiative for the homeless, Keep Wales Tidy biodiversity Awards and the Lincolnshire Energy Awards.

Customer awareness surveys

WPD's commitment to promoting customer awareness pre-dates any of the current regulatory or government pressures on distribution businesses to sharpen their focus on stakeholder engagement.

WPD began this process in a meaningful way in 2010 with the launch of the Power for Life initiative which is designed to raise awareness of the business and to better understand and respond to customer opinion and priorities. The 2015 campaign was WPD's sixth. A key part involves testing customer awareness levels of WPD and the effectiveness of our campaign annually with pre and post initiative surveys.

In 2010 and 2011 (pre Midlands acquisition), pre and post surveys were conducted involving face to face interviews with a total random sample of 855 people. Since 2012, the polls have involved 2,000 people each year.

Corporate and social responsibility (continued)

Customer awareness surveys (continued)
The 2015 research again suggested the campaign was effective with a seven percent awareness increase to 54% from 2014. There was also a good indication of the kind of information customers wanted to receive and their preferred methods for receiving it.

The feedback research from the 2014 campaign was used to shape the content of the 2015 campaign by responding to customers' preferences for power cut and contact information.

Environmental matters
See the Environmental section on page 10.

Greenhouse gas emissions
Our greenhouse gas reporting year is to 31 March. Emissions for the Company came from:

	tCO_2e		tCO_2e per employee	
	2016	2015	**2016**	2015
Scope 1 (direct emissions)				
Operational transport	**6,058**	7,666	**3.28**	4.22
SF6 gas (see page 11)	**1,030**	338	**0.56**	0.19
Fuel combustion (diesel)	**424**	401	**0.23**	0.22
Buildings	**127**	126	**0.07**	0.07
	7,639	8,531	**4.14**	4.70
Scope 2 (energy indirect emissions)				
Buildings electricity	**2,868**	3,209	**1.55**	1.77
Substation electricity	**10,322**	11,039	**5.59**	6.07
Surf Telecom	**145**	160	**0.08**	0.09
	13,335	14,408	**7.22**	7.93
Total scope 1 & 2	**20,974**	22,939	**11.36**	12.63
Scope 3 (other indirect emissions)				
Business transport	**1,591**	1,039	**0.86**	0.57
Total scope 1, 2 & 3	**22,565**	23,978	**12.22**	13.20

tCO_2e = tonnes of carbon dioxide equivalent

The Company's chosen intensity measurement is tonnes of carbon dioxide equivalent per employee.

The methodology used to calculate our emissions is based on the current guidance provided from DECC and the Department for Environment, Food and Rural Affairs ("DEFRA") Green House Gas Reporting Requirements and the UK Government conversion factors for Company Reporting (expiry 31 May 2014).

Employees
The average number of employees during the year was 1,848 (2015: 1,818). This includes a proportion of other WPD DNO staff who work in part for WPD East Midlands and excludes a proportion of WPD East Midlands staff who work in part for other WPD DNOs.

2 Strategic Report for the year to 31 March 2016

Corporate and social responsibility (continued)

Employees (continued)
WPD is committed to equality of opportunity in employment and this is reflected in its equal opportunities policy and employment practices. Employees are selected, treated, and promoted according to their abilities and merits and to the requirements of the job. Applications for employment by people with disabilities are fully considered, and in the event of members of staff becoming disabled, every effort is made to ensure that their employment with WPD continues by way of making adjustments to their role and/or working environment or through retraining arranged as appropriate. It is the policy of WPD that the training, career development and promotion of disabled persons should, as far as possible, be identical to that of other employees.

WPD places considerable value on the involvement of its employees in its affairs. Staff are kept informed of WPD's aims, objectives, performance and plans, and their effect on them as employees through monthly business updates, regular team briefings and other meetings, as well as through WPD's in-house journal. Formal meetings are held regularly between senior managers and representatives of staff and their unions to discuss matters of common interest. A series of road show presentations by the directors each year ensure that all staff are aware of, and can contribute to, WPD's corporate goals.

Human rights issues
WPD is dedicated to conducting its business with honesty, integrity and fairness. It is committed to the highest ethical standards. In support of these principles, it is the Company's policy to observe all domestic and applicable foreign laws and regulations.

In addition to conserving the human rights of its employees, WPD also considers those in relation to customers. Two specific customer groups whose needs are targeted by the Company are vulnerable customers and those in fuel poverty.

<u>Vulnerable customers</u>
WPD is required to hold a Priority Services Register ("PSR") that records details about vulnerable customers so that additional support can be provided when the customer contacts WPD or when their supply is interrupted. Bespoke services are provided by understanding the special needs of the customers.

WPD has established a dedicated team of people to proactively contact vulnerable customers and check the detail held about them. This is a process that will be repeated every two years to ensure that the register remains up to date. This will be supplemented by sharing data with other service centred organisations that hold information about vulnerable customers, provided customers give their consent and data protection allows. In the year to March 2016, WPD contact 543,401 customers and successfully updated 317,532 records.

Links have been established with many organisations such as the British Red Cross to improve the understanding of the needs of vulnerable customers. These partners work with WPD to improve the services that are provided and we will continue to work with them.

Help is provided for vulnerable customers during power cuts and where possible advice is provided to enable them to be prepared should a power cut occur.

Corporate and social responsibility (continued)

Human rights issues (continued)

Fuel poverty and energy affordability

Some customers on low incomes cannot afford to use electricity to effectively heat their properties. There is growing concern that customers will suffer as economic growth remains uncertain and austerity measures affect fuel poor customers further. Whilst WPD does not have a direct obligation to provide energy efficiency advice and support, in 2013 we introduced a social obligation strategy that is updated and reviewed by our Chief Executive annually, and includes actions WPD will take to address fuel poverty by helping customers to access information and support. In recent years we have worked with external partners such as the Centre for Sustainable Energy, the charity National Energy Action and with the Energy Saving Trust to provide information for our customers on the causes of and solutions for fuel poverty.

In 2014 WPD teamed up with the Coventry Citizens' Advice Bureau (CAB) to establish an innovative fuel poverty referral scheme called 'Power Up'. Initially as a one year pilot, the project helped customers by offering income and energy efficiency advice, such as benefits advice and energy saving tariffs and schemes. The service offered free, independent, confidential and impartial advice. The project works by Coventry CAB taking referrals directly from WPD following calls proactively made to vulnerable customers as part of WPD's update of the Priority Service Register. The scheme supported 694 fuel poor customers in 2014, leading to a range of positive interventions including saving customers a total of £33,000 a year.

Building on this successful model we have replicated this project and now have four 'Power Up' referral schemes – one in each DNO area, working with CAB in the Midlands, Energy Saving Trust in South Wales and the Centre for Sustainable Energy in the South West. Every customer contacted as part of WPD's PSR data cleanse is given the opportunity to be referred to a partner for support. Every project has the capacity to deliver all of the following interventions, in line with the customer's need:

1. Income maximisation (e.g. debt management)
2. Tariffs (e.g. switching tariff)
3. Energy efficiency (e.g. loft/cavity wall insulation schemes)
4. Affordable warmth (e.g. boiler replacement schemes)
5. Behavioural changes (e.g. more effectively managing heating/hot water systems).

In the 2015/16, these projects supported over 5,000 fuel poor customers, leading to total annual savings of over £830,000 for these customers.

By Order of the Board

RA Symons
Chief Executive Officer

18 July 2016

Western Power Distribution (East Midlands) plc
Avonbank
Feeder Road
Bristol
BS2 0TB

3 Corporate Governance

The Company is committed to the highest standards of corporate governance.

The Company is indirectly owned by one US-based corporate shareholder, PPL Corporation ("PPL" - see Section 4). The Company is thus not governed by many of the requirements of the Financial Services Authority. However, condition 44 of the Distribution Licence under which the Company operates requires it to publish a corporate governance statement as if it were subject to the UK Corporate Governance Code.

Board of directors

At 31 March 2016, the Board of the Company comprised WH Spence (Chairman, President and Chief Executive Officer of PPL Corporation) as non-executive director, four executive directors and two independent non-executive directors who together reflect a wide range of experience and expertise. One of the independent directors had previously been the Resources and External Affairs Director to the Western Power Distribution Holdings Limited Group (which then comprised WPD South West and WPD South Wales) until he retired on 31 March 2004 and the other independent director was, until retirement, a Senior Partner with Osborne Clarke, a large firm of solicitors.

The Board of Western Power Distribution plc ("WPD plc"), the holding company for the WPD Group, meets formally at least four times per annum. The Chairman is appointed by the Board. This Board comprises the same members as the Board of the Company, with the exception of the independent non-executive directors, plus four further PPL non-executive directors.

The Board of WPD plc has set the parameters by which the WPD plc Group is managed. These have been cascaded to all WPD subsidiaries. The directors are fully aware of their duties under the Companies Act 2006. Each director acts in good faith in a way considered to be most likely to promote the success of the Company for the benefit of the members as a whole.

WH Spence, as an executive officer of PPL Corporation, attends their Board meetings. He can thus communicate the views of PPL Corporation as the indirect 100% shareholder in the Company.

WPD plc needs to give its consent as indirect shareholder to the following:

- WPD plc Group business and strategic plans.
- establishing and setting the Terms of Reference for Sub-Committees of the Board.
- setting the financial limits of the Chief Executive and approving transactions above those limits.
- the issuance, sale or exchange of any debt or equity securities together with the approval of guarantees relating thereto.
- policies and practices to be followed in managing financial risk, including the use of derivatives and other hedging techniques.
- third party financing facilities in excess of £2m.
- the acquisition of stock in another company in excess of £2m.
- dividend payments
- the settlement of legal disputes in excess of £1m.
- annual financial accounts and directors' report.
- material capital projects.
- internal audit operational plan.

3 Corporate Governance (continued)

Board of directors (continued)

The Board has also set out a framework of authority levels within which the executive directors may operate. In addition, the WPD plc Group's executive directors, non-executive directors and other shareholder representatives informally discuss the Company's operations on a regular basis.

There were 10 meetings of the Board of the Company for the year ended 31 March 2016. Actual attendance was:

RA Symons, Chief Executive	10
DCS Oosthuizen, Finance Director	10
P Swift, Operations Director	10
IR Williams, Resources and External Affairs Director	10
RL Klingensmith, non-executive director and President PPL Global (resigned 16 July 2015)	2
WH Spence, non-executive director and Chairman, President and Chief Executive Officer of PPL Corporation (appointed 16 July 2015)	8
ME Fletcher, non-executive independent director	10
CR Watts, non-executive independent director	10

Attendance includes participation by telephone.

WPD's executive directors together with senior managers at PPL receive a detailed monthly group financial report. In addition, WPD's executive directors formally report both financial and non-financial performance for all operating companies at the WPD plc Board meetings.

Annually, the directors receive a briefing note from the Company's external legal advisors which reiterates their responsibilities as directors and which emphasises any legislative changes during the past year which impacts their responsibilities as directors.

In 2015, the performance of the executive directors of the Board in respect of a short-term bonus was measured through a number of goals and objectives set by the ultimate owners for the calendar year. These included:

- overall WPD profitability
- certain aspects of customer performance (as set out in Section 5)
- a discretionary element which considers safety, external affairs, compliance with Sarbanes-Oxley Act (discussed below), staff and management, IT and other items.

Board committees

Due to the nature of the ownership of the Company, there are no requirements for formal Nomination and Remuneration Committees. In particular, executive directors' remuneration has been set directly by PPL as shareholder. WPD's operations are subject to internal audit examination and the results reported to both the WPD plc Board and to PPL's Audit Committee.

The responsibility for audit is assumed by the Board as opposed to being delegated to a sub committee. As set out below, copies of all WPD Corporate Audit reports were submitted to the Corporate Audit Services Vice President at PPL during the year.

The Executive Committee comprises the executive directors and meets on a monthly basis. Matters requiring disclosure at Board level are defined within the Company's policy document 'Standards and Management'. The Company Secretary ensures that all relevant items are disclosed.

3 Corporate Governance (continued)

Responsibilities of the directors and external auditors in respect of the accounts

The respective responsibilities of the directors and of the external auditors are set out in Sections 6.1 and 6.2 respectively of this report.

Going concern basis

The financial statements have been prepared on a going concern basis as the directors consider that the Company has sufficient financial and other resources to continue in business for the foreseeable future.

More information is given under the 'Financial risk management objectives and policies' heading of Section 4 'Directors' Report'.

In addition, the directors of the Company are obliged under condition 30 of its licence to prepare a certificate annually which states that there are sufficient financial resources in place that will enable the Company to carry on the distribution business for 12 months from the date of signing that certificate. The external auditors then review this and report to the regulator, Ofgem.

Internal control environment

PPL Corporation has an audit committee that has oversight of the internal control environment across all PPL entities. The WPD Internal Audit Team completes a programme of internal audit work that provides independent assurance on internal controls. The WPD Internal Audit Team report to both the PPL Audit Committee and the WPD Board.

PPL's Audit Committee reviews and monitors the independence of the external auditor. The responsibility to monitor the financial reporting process and statutory audit of these financial statements is assumed by the UK Board. The Western Power Distribution plc Board comprises executive directors and non-executive directors. The board of WPD East Midlands also includes independent directors.

The directors of the WPD Group have overall responsibility for the system of internal controls and for reviewing the effectiveness of the system. The system of internal controls is designed to manage rather than eliminate the risk of failure to achieve business objectives. In pursuing these objectives, internal control can only provide reasonable and not absolute assurance against material mis-statement or loss.

There are many cultural features in WPD that contribute directly to the success of the Company and the results that it has achieved. These include:

- good definition and communication of short-term business objectives and targets.
- commitment to achievement of objectives and targets.
- speedy decision-making.
- business environment that empowers managers.
- an uncomplicated management structure that aids the flow of information both ways through the organisation.

In order for this success to occur, the control environment is one which empowers those with direct responsibility to take decisions within a clearly defined control framework. The control mechanisms have to be sufficient to limit risk but appropriate to the Company's ability to react quickly and effectively to events, therefore enabling the Company to deliver results over a sustained period of time.

It is important for an organisation to have a clearly defined structure of control expectations. The controls start at director level and make it clear to everyone concerned how the business should be conducted (policy) and how far each person can go in conducting that business (authority levels). This information is communicated effectively to all levels of staff.

3 Corporate Governance (continued)

Internal control environment (continued)

As WPD is owned by a US publicly quoted company, it is subject to the requirements of the US Sarbanes-Oxley Act of 2002. There are two main components of the Act, SOX 302 and SOX 404.

Under Section 302 of this Act, senior managers affirm quarterly that disclosure controls have been evaluated and are operating effectively, that there are no material internal control issues or, if there are, that they have been reported in line with PPL's requirements.

Section 404 is an annual process which includes the evaluation of internal controls for financial reporting. The WPD plc Group comply with these requirements via a two stage approach.

Firstly, Group level controls which are pervasive across the Group are documented and tested. The controls cover the COSO elements of effective internal control and the 17 principles set out in the COSO 2013 integrated framework. These encompass:

- control environment
- risk assessment
- information and communication
- control activities
- monitoring.

Secondly, all the major financial processes have been documented with specific detail on the controls in place. This includes the Information Technology environment which supports the financial processes. Management monitor these controls on an ongoing basis. In addition, the controls are reviewed and tested by the Internal Audit department and any issues identified are communicated back to management and the process owners to enable improvement to the controls.

Annually, the WPD plc Group's compliance with the Act is also reviewed in detail by WPD's external auditors. Good controls together with appropriate documentation must be maintained, and this is subject to testing by both internal and external auditors on an annual basis. Since inception of the Act, no control failures have been identified which merited public disclosure.

Identification and evaluation of risks and control objectives

The Company’s strategy is to follow an appropriate risk policy, which effectively manages exposures related to the achievement of business objectives.

Business process owners are responsible for identifying and assessing the key business risks associated with achieving the corporate objectives. Any actions required to further enhance the control environment are identified along with the person responsible for the management of the specific risk.

Periodically a review of key risks is undertaken by the Internal Audit team from which an Internal Audit operational plan is developed. The progression of this operational plan is communicated to the owners and the WPD plc Group Board on a quarterly basis as are all key observations.

The Internal Audit and Business Controls Team helps to ensure that the risk management and internal control system is consistently adopted, updated and embedded into the business processes.

Individual risk assessment reports highlight the most significant risks affecting the business process, the actions being taken to mitigate these, and also ensures that individuals are responsible for the management of these risks. This information is provided to the Board, the US owner's audit department, and also the external auditors.

3 Corporate Governance (continued)

Identification and evaluation of risks and control objectives (continued)

Further comment is given in Section 2 under 'Principal risks and uncertainties'.

Auditor independence

As mentioned above, PPL is subject to the US Sarbanes-Oxley Act of 2002. This Act not only requires documentation and review of internal controls but also details how audit committees, management, and auditors carry out their respective responsibilities and interact with each other. Its purpose is to build and restore confidence in public financial reporting within the US. The Act lays out specific requirements for each of these parties as it relates to corporate responsibilities, auditor regulation and independence, and financial reporting.

As a wholly owned entity of PPL, the requirements of the Sarbanes-Oxley Act of 2002 extend to WPD. One of the main elements of the Act is concerned with registered public auditing firms being unable to undertake non-auditing services if they are performing auditing services for the group. However a public accounting firm may engage in non-audit services, including tax services, for an audit client, but only if the activity is approved in advance (pre-approved) by the audit committee of the parent company. Therefore any non-auditing services required by WPD, other than those regarded as de-minimis, are detailed to PPL in advance and require their approval.

PPL has adopted a policy of tendering for its world-wide audit services at any time but no less frequently than every ten years. This is to ensure that best practice is followed in relation to corporate governance and that fees are competitive. Following a tender exercise during 2015, PPL selected Deloitte to replace Ernst & Young LLP. The appointment for the regulatory accounts will be effective for year ending 31 March 2017.

Code of Ethics and Legal Compliance Statement

WPD has developed a formal "Code of Ethics" that defines the standards of personal behaviour to which individual Board members and all employees are required to subscribe. This is subject to annual revision and frequent communication to all employees.

Similarly, WPD has a "Legal Compliance Programme – Statement of Policy" which is also issued periodically to employees. This states that WPD "is dedicated to conducting its business with honesty, integrity and fairness". It also states that WPD will not tolerate retaliation against any employee who reports any illegal act by the Company or by a fellow employee. Any such reports may be made to a line manager or to a named Compliance Officer within Human Resources, and may be made anonymously.

Code of conduct on fair competition

To ensure that the Company complies with its Distribution Licence and the Competition Act 1998, WPD has issued a "Code of conduct on fair competition". This is periodically updated and reissued to all staff; a copy is given to all new employees. It also applies to agents who work for WPD.

Political donations and expenditure

WPD is a politically neutral organisation and has made no political donations during the year.

4 Directors' Report

Registered company number

The Company's registered number is 2366923.

Ownership

WPD East Midlands is an indirect, wholly-owned subsidiary of Western Power Distribution plc, which is owned by PPL Corporation, an electricity utility of Allentown, Pennsylvania, US.

There were no transactions between WPD East Midlands and the ultimate owner.

Results and dividends

The profit for the year to 31 March 2016 is £189.2m (2015: £181.7m).

For the year to 31 March 2015 dividends paid by the Company totalled £52.4m (2015: £5.7m).

Political donations and expenditure

WPD is a politically neutral organisation and, during the year, made no political donations.

Financial risk management objectives and policies

WPD does not undertake transactions in financial derivative instruments for speculative purposes.

All debt at WPD East Midlands is denominated in sterling and therefore there is no currency risk exposure.

For further details of risks in relation to treasury operations see the "principal risks and uncertainties" section of the Strategic report.

Liquidity and going concern

On a day-to-day basis, WPD South West provides liquidity to WPD. It has borrowing arrangements in place with a range of third parties with high credit ratings. At 31 March 2016, WPD South West had committed borrowing facilities available in respect of which all conditions precedent had been met at that date of £245.0m maturing in January 2020, of which £35.0m was drawn. In addition, it had uncommitted facilities of £20.0m, of which £4.0m was drawn at 31 March 2016.

In addition, at 31 March 2016 the WPD Group's parent, Western Power Distribution plc, had a £210.0m committed borrowing facility that expires in January 2021 of which all conditions precedent had been met at that date; at 31 March 2016, it had drawn £141.2m against these facilities and thus had £68.8m undrawn. The drawdown was utilised to part fund the purchase of $200m Eurobonds (issued by the Company's ultimate UK parent) at a premium of $21m from a US based fellow subsidiary of PPL.

At 31 March 2016, WPD East Midlands had committed borrowing facilities available, in respect of which all conditions precedent had been met at that date, of £300m maturing in July 2019. Under this facility WPD East Midlands has the ability to request the lenders to issue up to £80m of letters of credit in lieu of borrowing. At 31 March 2016, no borrowings had been drawn against the facility and no letters of credit issued. In addition, WPD West Midlands has a similarly £300m facility and the four WPD DNOs have access to an uncommitted facility from which any DNO can draw but which in aggregate cannot exceed £20m. No borrowings had been drawn against these facilities as at 31 March 2016.

At 31 March 2016, WPD East Midlands had £1,182.2m (2015: £1,268.1m) of external debt outstanding of which £nil (2015: £146.0m) was short term. It had cash and short term deposits of £13.7m (2015: £2.0m).

Financial risk management objectives and policies (continued)

Liquidity and going concern (continued)

After consideration, the directors of the Company have concluded that the Company has sufficient resources available to enable it to continue in existence for the foreseeable future and at least for a period of 12 months from the date of signing of these Regulatory Financial Statements, and have therefore continued to adopt the going concern basis in preparing the financial statements. This consideration included the availability of facilities within the Company, an assessment of the net current liabilities, the relatively stable and regulated nature of the business, the forecast long term business plan, and the anticipated ability of the Company to be able to raise additional long term debt in the future.

Subsequent event

Subsequent to the year end, on 24 May 2016, WPD East Midlands entered into a £100m ten year index linked term loan agreement with the Bank of Tokyo-Mitsubishi UFJ, Ltd. The sum was drawn on 31 May 2016.

Dividend policy

The WPD Group is structured such that a proportion of the WPD Group's debt is issued by group companies other than WPD East Midlands, WPD West Midlands, WPD South West and WPD South Wales. Interest payments on this debt, together with other items, are funded primarily through dividend payments from WPD East Midlands, WPD West Midlands, WPD South West and WPD South Wales.

Dividends of £52.4m were paid by the Company on equity shares during the year (2015: £5.7m).

Strategic report

The following information required in the directors' report has been included in the strategic report:

- an indication of future developments in the business - see page 3;
- an indication of activities of the Company in the field of research and development - see page 14;
- a statement on the policy for disabled employees - see page 20;
- employee policies - see page 20;
- greenhouse gas (carbon) emissions - see page 20.

Directors and their interests

The directors who served during the year were as follows :

	Appointed
RA Symons, Chief Executive	1 April 2011
DCS Oosthuizen, Finance Director	1 April 2011
P Swift, Operations Director	1 July 2013
IR Williams, Resources and External Affairs Director	9 March 2015
RL Klingensmith, non-executive director and President PPL Global (resigned 16 July 2015)	1 April 2011
WH Spence, non-executive director and Chairman, President and Chief Executive Officer PPL Corporation	16 July 2015
ME Fletcher, non-executive independent director	31 October 2011
CR Watts, non-executive independent director	1 April 2014

During and at the end of the financial year, no director was materially interested in any contract of significance in relation to the Company's business other than service contracts.

4 Directors' Report (continued)

Directors and their interests (continued)

Insurance in respect of directors and officers is maintained by the WPD Group parent, PPL Corporation. The insurance is subject to the conditions set out in the Companies Acts and remains in ultimate force at the date of signing the Regulatory Financial Statements.

Corporate governance

A discussion of corporate governance in WPD is given in Section 3 to this report.

Statement of disclosure to the auditors

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow directors and the Company's auditor, each director has taken all the steps that he is obliged to take as a director in order to make himself aware of any relevant audit information and to establish that the auditor is aware of that information.

Responsibility statements under the Disclosure and Transparency Rules

Each of the current directors listed above confirm to the best of their knowledge:

(a) the Regulatory Financial Statements, prepared in accordance with UK Generally Accepted Accounting Practice, give a true and fair view of the assets, liabilities, financial position and profit of the Company; and

(b) the Strategic report and Directors' report include a fair review of the development and performance of the business and the position of the Company together with a description of the principal risks and uncertainties that it faces.

Independent auditors

The Company's ultimate parent undertaking, PPL Corporation, has adopted a policy of tendering for its world-wide audit services at least every ten years. This is to ensure that best practice is followed in relation to corporate governance and that fees are competitive. Following a tender exercise, PPL Corporation has selected Deloitte LLP to replace Ernst & Young LLP during 2016 for their various world-wide audits. Following approval of these Regulatory financial statements, Ernst & Young LLP will therefore resign as auditor to the Company and the directors will appoint Deloitte LLP to fill the casual vacancy.

By Order of the Board

RA Symons
Chief Executive

18 July 2016

Western Power Distribution (East Midlands) plc
Avonbank
Feeder Road
Bristol BS2 0TB

5 Statement on link between directors' pay and performance

Introduction

The bonus targets for the Chief Executive no longer contain an element relating to operational performance.

The other executive directors' bonus arrangements includes both financial and non financial performance criteria. The arrangements contain a substantial incentive to maintain and improve network reliability standards:

- goals for each element of performance are determined by the owner (PPL) at the beginning of each calendar year, specifying target and maximum goals together with associated target and maximum bonus amounts;

- following the end of the calendar year, results are compared with the goals, with the maximum amount paid if the maximum goals are met or exceeded; one half of the maximum if the target goals are met; or no payment if the target goals are not met.

There is also a discretionary element of the bonus which includes incentives relating to maintaining safety, enhancing communication, maintaining good employee relations and ensuring appropriate succession planning, satisfying the requirements of Sarbanes Oxley (as detailed in Section 3), and ensuring that WPD has reliable and robust IT systems.

Bonus payments are made annually based on a calendar year.

Year to 31 December 2015 goals and results

For the calendar year 2015, set out below are the bonus amounts related to standards of performance included in the annual bonus payment for 2015 based on targets determined at the beginning of the year:

	Maximum Bonus Amount (% of base pay)		
	Minutes lost per customer	Customer interruptions	**Total**
Finance Director	5.8%	5.8%	**11.7%**
Operations Director	5.1%	5.1%	**10.2%**
Resources & External Affairs Director	4.5%	4.5%	**9.0%**

The above goals relate to WPD as a whole. ‘Minutes lost per customer’ and ‘customer interruptions’ are defined as per Ofgem's Information and Incentives Scheme ("IIS") definitions. Operational goals no longer apply to the Chief Executive.

The WPD's results in 2015 exceeded all of Ofgem's IIS targets (on a pro rata basis for the calendar year) specified for these standards.

2016 Goals

The bonus structure for the 2016 annual bonus programme includes the two measures above (minutes lost per customer and customer interruptions) together with three additional Ofgem measures - the broad measure of customer satisfaction, stakeholder engagement, and connections engagement.

6.1 Statement of directors' responsibilities in respect of the Regulatory Financial Statements

Each DNO is a natural monopoly regulated by Ofgem. It is therefore subject to control on the prices it can charge and the quality of supply it must provide. The principal legislation governing the structure of the electricity industry in Great Britain is the Electricity Act 1989, as amended by the Utilities Act 2000 and the Energy Act 2004. This legislation provides for a licence framework in which the operations of the DNOs are regulated, pursuant to which income generated is subject to an allowed revenue regulatory framework that provides economic incentives to minimise operating, capital and financing costs consistent with the DNOs providing an acceptably reliable distribution network and meeting their legal responsibilities. This licence framework is overseen by Ofgem.

Licences which govern DNOs require each DNO to produce regulatory accounts. One of the documents which comprise the regulatory accounts is the Regulatory Financial Statements. This document contains the Regulatory Financial Statements, which are subject to audit.

The Regulatory Financial Statements are prepared on a similar basis to financial statements which a company is required to produce. Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom accounting standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that year. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently:
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors confirm that the Regulatory Financial Statements have complied with the above requirements.

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 the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

6.2 Independent auditors' report to the Gas and Electricity Markets Authority (the "Authority") and to Western Power Distribution (East Midlands) plc (the "Company")

We have audited the Regulatory Financial Statements of the Company for the year ended 31 March 2016 (the “Regulatory Financial Statements”) which comprise the Profit and loss account, the Statement of comprehensive income, the Statement of changes in equity, the Balance sheet, the Statement of cash flows and the related Notes 1 to 27. The financial reporting framework that has been applied in their preparation is Standard Condition 44 of the Electricity Distribution License ("the Regulatory Licence") and accounting policies set out on pages 40 through to 45.

This report is made, on terms that have been agreed, solely to the Company and the Authority in order to meet the requirements of Standard Condition 44 of the Regulatory Licence. Our audit work has been undertaken so that we might state to the Company and the Authority those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under the Regulatory Licence to procure such a report and (b) to facilitate the carrying out by the Authority of its regulatory functions, 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 Authority, for our audit work, for this report or for the opinions we have formed.

Respective responsibilities of the Authority, the Directors and Auditors

As explained more fully in the Statement of Directors’ Responsibilities set out on page 33, the directors are responsible for the preparation of the Regulatory Financial Statements and for their fair presentation in accordance with the basis of preparation and accounting policies. Our responsibility is to audit and express an opinion on the Regulatory Financial Statements in accordance with International Standards on Auditing (UK and Ireland), except as stated in the ‘Scope of the audit of the Regulatory Financial Statements’ below, and having regard to the guidance contained in Audit 05/03 ‘Reporting to Regulators of Regulated Entities’ issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board’s Ethical Standards for Auditors.

Scope of the audit of the Regulatory Financial Statements

An audit involves obtaining evidence about the amounts and disclosures in the Regulatory Financial Statements sufficient to give reasonable assurance that the Regulatory Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company’s circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the Regulatory Financial Statements. In addition, we read all the financial and non-financial information in the Strategic report, Corporate governance report, Directors report and Statement on link between directors’ pay and standards of performance & Regulatory Financial Statements to identify material inconsistencies with the audited Regulatory Financial Statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent misstatements or inconsistencies we consider the implications for our report.

We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Standard Condition 44 of the Company’s Regulatory Licence. Where Standard Condition 44 does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Regulatory Financial Statements are consistent with those used in the preparation of the statutory financial statements of the Company. Furthermore, as the nature, form and content of Regulatory Financial Statements are determined by the Authority, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK & Ireland).

6.2 Independent auditors' report to the Gas and Electricity Markets Authority (the "Authority") and to Western Power Distribution (East Midlands) plc (the "Company") (continued)

Opinion on Regulatory Financial Statements

In our opinion the Regulatory Financial Statements:

- have been properly prepared in accordance with Standard Condition 44 of the Company’s Regulatory Licence and the accounting policies set out on pages 40 through to 45.

Basis of preparation

Without modifying our opinion, we draw attention to the fact that the Regulatory Financial Statements have been prepared in accordance with Standard Condition 44 of the Company’s Regulatory Licence and the accounting policies set out in the statement of accounting policies.

The nature, form and content of Regulatory Financial Statements are determined by the Authority. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the Authority's purposes. Accordingly we make no such assessment.

The Regulatory Financial Statements are separate from the statutory financial statements of the Company which have been prepared under United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006.

Other matters

Our opinion on the Regulatory Financial Statements is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2016 which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our “Statutory audit”) was made solely to the Company’s members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company’s members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Ernst & Young LLP
Statutory Auditor
Bristol
19 July 2016

1 The maintenance and integrity of the Company’s web site is the responsibility of the directors and the maintenance and integrity of the Regulator’s web site is the responsibility of the Regulator; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Regulatory Financial Statements since they were initially presented on the web sites.

2 Legislation in the United Kingdom governing the preparation and dissemination of financial statements and Regulatory Financial Statements may differ from legislation in other jurisdictions.

6.3 Profit and loss account

For the year ended 31 March 2016

	Note	**2016 £m**	2015 £m
Turnover	4	**451.0**	469.0
Operating expenses	5	**(179.1)**	(181.2)
Operating profit	6	**271.9**	287.8
Profit on disposal of fixed assets		**0.3**	0.2
Profit on ordinary activities before interest and tax		**272.2**	288.0
Interest receivable and similar income	7	**0.1**	-
Interest payable and similar charges	7	**(61.7)**	(60.8)
Net interest expense relating to pensions and other post-retirement benefits	11	**(4.0)**	(4.7)
Profit on ordinary activities before tax	4	**206.6**	222.5
Tax on profit on ordinary activities	8	**(17.4)**	(40.8)
Profit for the financial year		**189.2**	181.7

The comparative results have been restated following the adoption of FRS 101 as set out in Note 25.

All activities relate to continuing operations.

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

6.4 Statement of comprehensive income

For the year ended 31 March 2016

	Note	**2016 £m**	2015 £m
Profit for the financial year		**189.2**	181.7
Other comprehensive loss:			
Other comprehensive (loss)/income to be reclassified to profit or loss in subsequent periods			
Losses arising on cash flow hedges during the year		**(0.8)**	0.6
Reclassification adjustments for losses on cash flow hedges included in profit or loss (interest payable)		**0.6**	
Income tax effect			
Impact of tax rate change		**(0.1)**	-
Other		**-**	(0.1)
		(0.3)	0.5
Other comprehensive income/(loss) not to be reclassified to profit or loss in subsequent periods			
Re-measurement gains/(losses) on defined benefit pension plan	11	**86.6**	(49.5)
Re-measurement gain on unfunded pension liability	11	**0.3**	-
Income tax effect:			
Impact of tax rate change		**(0.1)**	
Other		**(17.3)**	9.9
		69.5	(39.6)
Other comprehensive income/(loss) for the year, net of tax		**69.2**	(39.1)
Total comprehensive income for the year, net of tax, attributable to equity holders of the parent		**258.4**	142.6

6.5 Statement of changes in equity

For the year ended 31 March 2016

	Share capital £m	Share premium £m	Hedging reserve £m	Retained earnings £m	Total equity £m
At 1 April 2014	117.6	46.2	(6.0)	536.2	694.0
Profit for the year	-	-	-	181.7	181.7
Other comprehensive income/(loss)	-	-	0.5	(39.6)	(39.1)
Total comprehensive income for the year	-	-	0.5	142.1	142.6
Equity dividends paid	-	-	-	(5.7)	(5.7)
At 31 March 2015	117.6	46.2	(5.5)	672.6	830.9
Profit for the year	-	-	-	189.2	189.2
Other comprehensive (loss)/income	-	-	(0.3)	69.5	69.2
Total comprehensive (loss)/income for the year	-	-	(0.3)	258.7	258.4
Share issue	30.0	-	-	-	30.0
Equity dividends paid	-	-	-	(52.4)	(52.4)
At 31 March 2016	**147.6**	**46.2**	**(5.8)**	**878.9**	**1,066.9**

6.6 Balance sheet

31 March 2016

	Note	**2016 £m**	2015 £m
Fixed assets			
Tangible assets	13	**3,559.7**	3,308.3
Intangible assets	14	**1.5**	0.8
		3,561.2	3,309.1
Current assets			
Stocks	15	**8.9**	8.1
Debtors	16	**108.1**	89.5
Cash at bank	17	**13.7**	2.0
		130.7	99.6
Creditors			
Amounts falling due within one year	18	**(394.2)**	(359.7)
Net current liabilities		**(263.5)**	(260.1)
Total assets less current liabilities		**3,297.7**	3,049.0
Creditors			
Amounts falling due after more than one year	18	**(2,034.1)**	(1,917.5)
Provisions for liabilities and charges			
Deferred tax	19	**(155.7)**	(137.3)
Other	19	**(14.4)**	(15.8)
Pension liability	11	**(26.6)**	(147.5)
Net assets		**1,066.9**	830.9
Capital and reserves			
Called-up share capital	21	**147.6**	117.6
Share premium account	22	**46.2**	46.2
Hedging reserve	22	**(5.8)**	(5.5)
Profit and loss account	22	**878.9**	672.6
Equity shareholders' funds		**1,066.9**	830.9

The comparative balance sheet has been restated following the adoption of FRS 101 as set out in Note 25.

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

The Regulatory Financial Statements on pages 35 to 72 were approved by the Board of Directors on 18 July 2016 and were signed on its behalf by:

RA Symons	DCS Oosthuizen
Chief Executive	Finance Director

6.7 Statement of cash flows

For the year ended 31 March 2016

	Note	**2016 £m**	2015 £m
Operating activities			
Profit for the period		**189.2**	181.7
Adjustments to reconcile profit for the year to net cash flows from operating activities:			
Tax expense		**17.4**	40.8
Interest payable		**65.7**	65.5
Interest receivable		**(0.1)**	-
Depreciation of tangible fixed assets	6	**67.2**	76.3
Amortisation of customer contributions		**(15.4)**	(7.0)
Amortisation of intangible assets		**0.5**	0.4
Gain on disposal of tangible fixed assets		**(0.3)**	(0.2)
Difference between pension contributions paid and amounts recognised in the income statement		**(34.1)**	(41.2)
Decrease in provisions		**(1.4)**	(2.2)
Working capital adjustments:			
(Increase)/decrease in inventories		**(0.8)**	1.9
Decrease/(increase) in trade and other receivables		**3.8**	(4.8)
(Decrease)/increase in trade and other payables		**(5.8)**	7.3
Interest paid		**(58.8)**	(58.3)
Interest received		**0.1**	-
Income taxes paid		**(20.0)**	(34.9)
Net cash from operating activities		**207.2**	225.3
Investing activities			
Purchase of tangible fixed assets		**(325.1)**	(364.8)
Customers' contributions received		**75.1**	62.7
Proceeds from sale of tangible fixed assets		**0.4**	0.2
Transfer of tangible fixed assets from other Group undertakings		**-**	(6.3)
Purchase of intangible assets		**(1.2)**	-
Net cash used in investing activities		**(250.8)**	(308.2)
Financing activities			
Net proceeds from issue of share capital		**30.0**	-
Net (decrease)/increase in short-term borrowings		**(146.0)**	146.0
Proceeds from long-term borrowings		**56.8**	-
Movement in balances with Group undertakings		**166.9**	(59.5)
Dividends or equivalent distributions paid		**(52.4)**	(5.7)
Net cash (used in)/from financing activities		**55.3**	80.8
Net increase/(decrease) in cash and cash equivalents		**11.7**	(2.1)
Cash and cash equivalents at beginning of year		**2.0**	4.1
Cash and cash equivalents at end of year	17	**13.7**	2.0

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

1. Authorisation of regulatory financial statements and statement of compliance with FRS 101

The regulatory financial statements of Western Power Distribution (East Midlands) plc ("the Company") for the year ended 31 March 2016 were authorised for issue by the Board of Directors on 18 July 2016 and the balance sheet was signed on the Board's behalf by R A Symons and D C S Oosthuizen. The Company is a public limited company incorporated and domiciled in England and Wales.

These regulatory financial statements were prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework ("FRS 101") and in accordance with applicable accounting standards. The Company's regulatory financial statements are presented in Sterling and all values are rounded to the nearest hundred thousand pounds except when otherwise indicated.

2. Significant accounting policies

Basis of preparation

The Company has transitioned to FRS 101 from previously extant UK Generally Accepted Accounting Practice for all periods presented. Transitional tables showing all material adjustments are disclosed in Note 25.

As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to financial instruments, capital management, presentation of comparative information in respect of certain assets, standards not yet effective, related party transactions and share based payments.

Where required, equivalent disclosures are given in the group accounts of Western Power Distribution plc. The group accounts of Western Power Distribution plc are available to the public and can be obtained as set out in Note 27.

The regulatory financial statements have been prepared on the historical cost basis. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

The principal accounting policies adopted are set out below.

Going concern

The directors have prepared the regulatory financial statements on a going concern basis as they have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future due to the strength of its balance sheet. This is discussed further under 'Financial risk management objectives and policies' within the Directors' report.

Turnover

Turnover is recognised to the extent that it is probable that economic benefits will flow to the Company and that the turnover can be reliably measured. Turnover comprises primarily use of energy system income. Turnover includes an assessment of the volume of unbilled energy distributed to customers between the date of the last meter reading and the year end. Remaining sales relate to the invoice value of other goods and services provided which also relate to the electricity network.

2. Significant accounting policies (continued)

Turnover (continued)

Where turnover received or receivable exceeds the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over-recovery, no liability is recognised as such an adjustment to future prices relates to the provision of future services. Similarly no asset is recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under-recovery.

Contributions

Contributions receivable in respect of tangible fixed assets are treated as deferred income, which is credited to the income statement over the estimated weighted life of the related assets of 69 years.

Finance costs

Finance expenses comprise interest payable on borrowings, the release of discount on provisions, and interest on pension scheme liabilities. Interest charges are recognised in the profit and loss account as they accrue, on an effective rate basis.

Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

WPD East Midlands as a lessee

Leases where the lessor retains a significant portion of the risks and benefits of ownership of the assets are classified as operating leases and rentals payable are charged to the income statement on a straight line basis over the lease term.

Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation and impairments. Borrowing costs directly attributable to assets under construction and which meet the recognition criteria in International Accounting Standard ("IAS 23") are capitalised as part of the cost of that asset.

Expenditure on electricity infrastructure assets relating to increases in capacity or enhancements of the network including qualifying replacement expenditure are treated as additions. Other costs incurred in maintaining the operating capability of the network in accordance with defined standards of service are expensed in the year in which the expenditure is incurred.

Cost comprises the aggregate amount paid and the fair value of any other consideration given to acquire the asset and includes costs directly attributable to making the asset capable of operating as intended. Employee costs incurred in implementing capital schemes are capitalised within infrastructure assets together with the cost of materials and an appropriate proportion of production overheads.

Contributions received towards the cost of tangible fixed assets which include low carbon network funding are included in trade and other payables as deferred income and credited on a straight-line basis to the profit and loss account over the estimated economic useful lives of the assets to which they relate.

2. Significant accounting policies (continued)

Tangible fixed assets (continued)

Depreciation is provided on all tangible fixed assets, other than land, on a straight-line basis over its expected useful life as follows:

	Years
Distribution network assets:	
Overhead lines and poles	65
Underground cables	85
Plant and machinery (transformers and switchgear)	55
Meters	3
Other (towers and substation buildings)	Up to 80
Buildings - freehold	Up to 60
Fixtures and equipment	Up to 20
Vehicles and mobile plant	Up to 10

The carrying values of tangible fixed assets are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable, and are written down immediately to their recoverable amount. Useful lives and residual values are reviewed annually and where adjustments are required these are made prospectively.

An item of tangible fixed assets is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the derecognition of the asset is included in the income statement in the period of derecognition.

Intangible assets

Costs directly associated with the development of computer software for internal use are capitalised where technical feasibility can be demonstrated, the Company is satisfied that future economic benefits will flow to the Company and the cost can be separately identified and reliably measured. Software is measured initially at cost and amortised on a straight-line basis over its estimated useful life. Carrying amount is reduced by any provision for impairment where necessary. The estimated useful life assigned to computer software is up to five years.

Stocks

Stocks are valued at the lower of cost and net realisable value. Cost is determined using the weighted average method and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. It excludes borrowing costs.

Taxation

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the balance sheet date.

Deferred income tax is recognised on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements, with the following exceptions:

- where the temporary difference arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss;

2. Significant accounting policies (continued)

Taxation (continued)

- deferred income tax assets are recognised only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised.

Deferred income tax assets and liabilities are measured on an undiscounted basis at the tax rates that are expected to apply when the related asset is realised or liability is settled, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date. Deferred income tax assets and liabilities are offset only if a legally enforceable right exists to set off current tax assets against current tax liabilities, the deferred income taxes relate to the same taxation authority and that authority permits the Company to make a single net payment.

Income tax is charged or credited to other comprehensive income if it relates to items that are charged or credited to other comprehensive income. Similarly, income tax is charged or credited directly to equity if it relates to items that are credited or charged directly to equity. Otherwise income tax is recognised in the profit and loss account.

Pension benefits

The Company participates in one defined benefit pension plan, which is a section of the industry-wide Electricity Supply Pension Scheme ('ESPS'). The ESPS scheme is, with very limited exception, closed to new members. A defined contribution plan is offered to new employees. The Company also has an unfunded pension liability in respect of previous executives.

The ESPS is a group defined benefit pension plan that shares risks between entities under common control. Under FRS 101, the scheme has been accounted for as a defined benefit scheme by the Company as it has legal responsibility for the plan which it holds jointly with WPD West Midlands. The net defined benefit cost and net deficit of the plan have been allocated to WPD East Midlands and WPD West Midlands in accordance with pensionable salaries.

The cost of providing benefits under the defined benefit plan is determined using the projected unit credit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of defined benefit obligation) and is based on actuarial advice. Past service costs, resulting from either a plan amendment or a curtailment (a reduction in future obligations as a result of a material reduction in the plan membership), are recognised immediately when amendments or curtailments occur.

Net interest expense related to pension benefits represents the net change in the present value of plan obligations and the value of plan assets resulting from the passage of time, and is determined by applying the discount rate to the present value of the benefit obligation at the start of the year and to the fair value of plan assets at the start of the year, taking into account expected changes in the obligation or plan assets during the year. Net interest expense relating to pension benefits is recognised in the profit and loss account.

Remeasurement of the net defined benefit liability or asset, comprising actuarial gains or losses, and the return on plan assets (excluding amounts included in net interest described above) are recognised with other comprehensive income in the period in which they occur.

2. Significant accounting policies (continued)

Pension benefits (continued)
The defined benefit pension plan surplus or deficit in the balance sheet comprises the total of the present value of the defined benefit obligation (using a discount rate based on high quality corporate bonds), less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on the market price information and in the case of quoted securities is the published bid price.

Contributions to defined contribution schemes are recognised in the profit or loss account or capital expenditure as appropriate in the year in which they become payable.

Share-based payments
The cost of cash-settled transactions is measured at fair value using an appropriate option pricing model. Fair value is established at each balance sheet date from grant date until the awards are settled. During the vesting period a liability is recognised representing the product of the fair value of the award and the portion of the vesting period expired as at the balance sheet date. From the end of the vesting period until settlement, the liability represents the full fair value of the award as at the balance sheet date. Changes in the carrying amount of the liability are recognised in profit or loss for the year.

Provisions
Provisions are recognised when the Company has a legal or constructive obligation as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. If the effect is material, expected future cash flows are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability.

Dividend distribution
Dividend distribution to the Company's shareholders is recognised as a liability in the financial statements in the year in which the dividends are approved by the Company's directors.

Financial assets
Financial assets are classified as loans and receivables; financial assets at fair value through profit or loss; derivatives designated as hedging instruments in an effective hedge; held-to-maturity financial assets; or as available-for-sale financial assets, as appropriate. The Company's financial assets include cash and cash equivalents, trade receivables, other receivables and loans. The Company determines the classification of its financial assets at initial recognition. Financial assets are recognised initially at fair value, normally being the transaction price plus, in the case of financial assets not at fair value through profit or loss, directly attributable transaction costs.

The subsequent measurement of financial assets depends on their classification as follows:

Loans and receivables
Loans and receivables are carried at amortised cost using the effective interest method. Trade and other debtors are recognised and carried at the lower of their original invoiced amount and recoverable amount. Provision for impairment is made through the profit and loss account when there is objective evidence that the company will not be able to recover balances in full. Balances are written off when the probability of recovery is assessed as being remote.

Cash equivalents are short-term highly liquid investments that are readily convertible to known amounts of cash, are subject to insignificant risk of changes in value and have a maturity of three months or less from the date of acquisition.

2. Significant accounting policies (continued)

Financial liabilities

Financial liabilities are classified as financial liabilities at fair value through profit or loss; derivatives designated as hedging instruments in an effective hedge; or as financial liabilities measured at amortised cost, as appropriate. The Company's financial liabilities include trade and other payables, accruals and interest bearing loans and borrowings. The Company determines the classification of its financial liabilities at initial recognition. The measurement of financial liabilities depends on their classification, as follows:

Financial liabilities measured at amortised cost

All other financial liabilities are initially recognised at fair value. For interest-bearing loans and borrowings this is the fair value of the proceeds received net of directly attributable issue costs.

After initial recognition, interest bearing loans are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement. Gains and losses arising on the repurchase, settlement or cancellation of liabilities are recognised respectively in interest and other income and finance costs.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of the respective assets. All other borrowing costs are expensed in the period they occur. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

3. Critical accounting judgements and key sources of estimation uncertainty

In the application of the Company’s accounting policies, which are described in Note 2, the directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

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

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

3. Critical accounting judgements and key sources of estimation uncertainty (continued)

Pension obligations

The Company has a commitment, mainly through the ESPS, to pay pension benefits. The cost of these benefits and the present value of the Company's pension liabilities depend on such factors as the life expectancy of the members, the salary progression of current employees, the return that the pension fund assets will generate in the time before they are used to fund the pension payments and the discount rate at which the future pension payments are discounted. Based on advice from external actuaries, the Company uses estimates for all these factors in determining the pension costs and liabilities incorporated in the financial statements. The assumptions reflect historical experience and management's judgement regarding future expectations. Refer to Note 11 for sensitivity information.

4. Segmental reporting

Condition 44.7 of the licence requires a segmental analysis as follows:

	Turnover 2016 £m	**Operating expenses 2016 £m**	**Operating profit 2016 £m**	**Capital expenditure 2016 £m**
Distribution	**437.0**	**(165.2)**	**271.8**	**280.2**
Distributed generation	**1.6**	**(1.0)**	**0.6**	**19.0**
Directly remunerated services (excluding meteri	**4.9**	**(5.7)**	**(0.8)**	**31.7**
Metering equipment and services	**4.1**	**(4.0)**	**0.1**	**-**
De minimis	**3.4**	**(3.2)**	**0.2**	**1.0**
Other consented services	**-**	**-**	**-**	**-**
Out of area networks	**-**	**-**	**-**	**-**
	451.0	**(179.1)**	**271.9**	**331.9**

	Turnover 2015 £m	Operating expenses 2015 £m	Operating profit 2015 £m	Capital expenditure 2015 £m
Distribution	442.2	(164.1)	278.1	341.0
Distributed generation	3.7	(0.9)	2.8	15.3
Directly remunerated services (excluding meteri	12.7	(8.7)	4.0	27.3
Metering equipment and services	4.0	(4.2)	(0.2)	-
De minimis	6.4	(3.3)	3.1	0.9
Other consented services	-	-	-	-
Out of area networks	-	-	-	-
	469.0	(181.2)	287.8	384.5

4. Segmental reporting (continued)

Directly remunerated services (excluding metering), previously called excluded services, comprise connection services, diversionary works under an obligation, works required by any alteration of premises, top-up, standby and enhanced system security and revenue protection services which are defined as per the licence conditions.

De minimis activity is business conducted or carried on by the licensee other than the distribution business as defined in the licence conditions.

Other consented activity is any business or activity conducted or carried on by the licensee other than the distribution business to which Ofgem has given its consent in accordance with paragraph 29.4(c) of the licence. This includes internal income from other WPD companies and associated costs.

Values shown are based on amounts reported to Ofgem under the relevant Regulatory Instructions and Guidance. The basis of allocation to segments may therefore change between years as these instructions change. This is particularly true between price controls; values in 2014/15 were reported under the DPCR5 Regulatory Instructions and Guidance whereas values reported in 2015/16 are reported under those for RIIO-ED1.

Total costs in the prior year have been restated to take account of the transition to FRS 101.

Revenue from five customers amounted to £123.5m, £77.6m, £61.7m, £60.5m and £58.6m (2015: £113.4m, £68.4m, £55.5m, £52.5m and £54.0m).

5. Operating expenses

The directors consider that the nature of the business is such that the analysis of expenses shown below is more informative than that set out in the formats specified by the Companies Act 2006.

	2016 £m	2015 £m
Employee costs (Note 10)	**36.3**	32.9
Depreciation	**67.2**	76.1
Amortisation of intangible assets	**0.5**	0.4
Amortisation of customer contributions	**(15.4)**	(17.4)
Property taxes	**37.0**	36.2
Other operating expenses	**53.5**	53.0
Operating expenses	**179.1**	181.2

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

6. Operating profit	**2016** **£m**	2015 £m
Operating profit is stated after charging:		
Depreciation *	**67.2**	76.1
Amortisation of intangible assets	**0.5**	0.4
Operating lease rentals:		
Plant, machinery and equipment	**4.3**	5.8
Land and buildings	**3.2**	3.0
Amortisation of customer contributions	**(15.4)**	(17.4)
Research and development **	**0.1**	0.1
Auditors' remuneration:		
Fees payable to the Company's auditors for the audit of the Company's annual accounts	**0.3**	0.2
Non audit fee	**-**	-

* Depreciation of fixed assets is stated net of depreciation capitalised of £12.0m (2015: £11.1m) in respect of equipment consumed during the construction of the electricity network.

** Research and development costs above exclude expenditure on Low Carbon Network and Network Innovation Allowance projects which is capitalised together with associated funding received.

7. Net interest

	2016 **£m**	2015 £m
Interest receivable		
Other	**(0.1)**	-
Total interest receivable	**(0.1)**	-
Interest payable		
Interest payable on bank loans and overdrafts	**0.7**	1.7
Interest payable on loans from other WPD undertakings	**0.9**	1.0
Interest payable on other loans	**61.0**	59.6
Less: interest capitalised	**(0.9)**	(1.5)
Total interest payable	**61.7**	60.8
Net interest expense	**61.6**	60.8

Interest in 2016 was capitalised at a rate of 3.4% (based on the yield on the Company's borrowings).

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

8. Tax

Tax charged to the profit and loss account:

	2016 £m	2015 £m
Current tax:		
UK corporation tax on profits for the year	**16.5**	26.9
Adjustment in respect of prior years	**(0.1)**	-
Deferred tax (Note 20):		
Relating to the origination and reversal of timing differences	**20.9**	14.4
Impact of tax rate change	**(19.9)**	-
Adjustment in respect of prior years	**-**	(0.5)
Tax expense in the profit and loss account	**17.4**	40.8

The tax on the Company's profit before tax differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK of 20% (2015: 21%) as follows:

	2016 £m	2015 £m
Profit on ordinary activities before tax	**206.6**	222.5
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 20% (2015: 21%)	**41.3**	46.7
Effects of:		
Expenses not deductible and income not taxable for tax purposes	**(0.1)**	(0.4)
Impact of tax rate change	**(19.9)**	-
Adjustments to tax charge in respect of prior years	**(0.2)**	(0.5)
Group relief received for free	**(3.7)**	(5.0)
Total tax expense reported in the profit and loss account	**17.4**	40.8

In addition to the amount charged to the profit and loss account, the following amounts relating to tax have been recognised in other comprehensive income.

	2016 £m	2015 £m
Deferred tax:		
On cash flow hedges	**0.1**	0.1
On remeasurement gain/(loss) on defined benefit pension scheme	**17.3**	(9.9)
Total tax expense/(credit) in the statement of other comprehensive income	**17.4**	(9.8)

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

8. Tax (continued)

Change in corporation tax rate

The Finance (No 2) Act 2015 reduced the standard rate of corporation tax from 20% to 19% with effect from 1 April 2017 and then to 18% with effect from 1 April 2020. These changes have been enacted and the impact included in these financial statements. Legislation will be introduced in the Finance Bill 2016 to be enacted later in 2016 to reduce the rate further to 17%, effective 1 April 2020 (superseding the 18% rate). The impact has not been included in these financial statements.

9. Dividends

	2016	2015
	£m	£m
Dividends on equity shares:		
Interim dividends - 25.3 pence per share (2015: 2.8 pence)	**52.4**	5.7

The WPD Group is structured such that a proportion of the WPD Group's debt is issued by group companies other than WPD East Midlands, WPD West Midlands, WPD South West and WPD South Wales. Interest payments on this debt, together with other items, are funded primarily through dividend payments from WPD East Midlands, WPD West Midlands, WPD South West and WPD South Wales.

10. Employee benefit expense

Employee benefit expense, including directors' remuneration, was as follows:

	2016	2015
	£m	£m
Wages and salaries	**90.8**	86.0
Social security costs	**10.0**	9.4
Pension costs	**16.6**	13.0
Total employee costs	**117.4**	108.4
Less allocated to capital expenditure	**(81.1)**	(75.5)
Charged to the profit and loss account	**36.3**	32.9

There are no personnel, other than the directors, who as key management have authority and responsibility for planning, directing and controlling activities, directly or indirectly, of the Company.

The average number of employees during the year was 1,848 (2015: 1,818). All employees work for the network distribution activity. This includes a proportion of other WPD DNO staff who work in part for WPD East Midlands and excludes a proportion of WPD East Midlands staff who work in part for other WPD DNOs.

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

10. Employee benefit expense (continued)

Share based payments

WPD issues share appreciation rights ("SARs") to executive directors and senior employees relating to the shares of WPD's ultimate parent, PPL Corporation. SARs become exercisable in equal instalments over a three year service period beginning one year after the date of grant, assuming the individual is still employed by WPD, and expire no later than ten years from the grant date. The SARs require WPD to pay the intrinsic value of the SAR to the executive director or employee at the date of exercise.

SARs are recorded at their fair value which is determined using the Black-Scholes option-pricing model. At 31 March 2016 WPD had recorded liabilities of £1.9m (2015: £0.9m) and in 2016 recorded total charges of £2.2m (2015: £0.2m credit) allocated between WPD South West, WPD South Wales, WPD East Midlands and WPD West Midlands.

At 31 March 2016 WPD had 531,792 SARs outstanding (2015: 668,831) which had exercise prices in the range £24.72 - £13.86 (2015: £24.14 - £15.38). The weighted average fair value of options granted during the regulatory year was £2.72 (2015: £1.17).

As a result of PPL Corporation's spinoff during the year of its competitive power generation business to form Talen Energy Corporation, adjustments were made to the outstanding and unexercised phantom stock option awards. Based on the pre and post-spin off PPL share prices an exchange ratio was calculated and all outstanding and unexercised options were multiplied by this ratio. The exercise price of each outstanding stock option was also reduced by the same ratio.

11. Pension commitments

Electricity Supply Pension Scheme ("ESPS")

The ESPS provides pension and other related defined benefits based on final pensionable pay to employees throughout the electricity industry. One segment of the ESPS (the Central Networks Group segment) relates to WPD East Midlands and WPD West Midlands and most employees of these companies are members of the ESPS. The assets are held in a trustee administered fund.

The Central Networks Group segment of the ESPS is closed to new members except in very limited circumstances; existing members are unaffected. A defined contribution scheme is offered to new employees.

The liability recognised in the balance sheet in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the end of the reporting period less the fair value of the plan assets. The defined benefit obligation is calculated annually by independent actuaries, Aon Hewitt Limited, using the projected unit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits are paid, and that have terms to maturity approximating to the terms of the related pension obligation.

Actuarial gains and losses arising from experience adjustments and changes to actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise.

Past-service costs are recognised immediately in income.

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

11. Pension commitments

Electricity Supply Pension Scheme ("ESPS") (continued)

The scheme is a funded, defined benefit, final salary pension plan. The level of benefits provided depends on members' length of service and their salary at their date of leaving the Company. The majority of pensions in payment receive inflationary increases in line with the RPI (Retail Prices Index) inflation. The benefit payments are from trustee-administered funds. The amount of contributions to be paid is decided jointly by the employer and the Trustees of the Scheme.

Assets held in trust are governed by UK regulations and practice. The Scheme's investment strategy is decided by the Trustees, in consultation with the employer. The board of Trustees must be composed of representatives of the employer and plan participants in accordance with the Scheme's legal documentation.

The net defined benefit cost and net deficit of the plan have been allocated to WPD East Midlands and WPD West Midlands in accordance with pensionable salaries, currently 49.2% to WPD East Midlands (2015: 49.2%). The figures below show the proportion allocated to WPD East Midlands.

The Company also has an unfunded liability in respect of previous executives.

The amounts recognised in WPD East Midlands' balance sheet are determined as follows:

	2016 **£m**	2015 £m
Present value of obligations	**1,442.0**	1,591.7
Fair value of plan assets	**(1,418.9)**	(1,448.1)
Deficit in the scheme	**23.1**	143.6
Unfunded pension obligation	**3.5**	3.9
Total pension liability recognised in the balance sheet	**26.6**	147.5

The regulator, Ofgem, currently allows ongoing service costs and a proportion of the deficit costs to be recovered through regulated income.

11. Pension commitments (continued)

Electricity Supply Pension Scheme ("ESPS") (continued)

Analysis of the amount charged to profit before interest and taxation:

	2016 £m	2015 £m
Current service cost	**14.6**	11.2
Administrative costs	**1.0**	0.9
Operating charge relating to defined benefit plans	**15.6**	12.1
Interest income on plan assets	**(44.7)**	(53.4)
Interest on plan liabilities	**48.6**	58.1
Interest on unfunded liabilities	**0.1**	-
Other finance expense	**4.0**	4.7

Analysis of the amount recognised in other comprehensive income:

	2016 £m	2015 £m
Loss/(gain) on plan assets excluding amounts included in interest incom	**63.0**	(156.0)
Gain from change in demographic assumptions	**(51.1)**	-
(Gain)/loss from change in financial assumptions	**(76.6)**	211.7
Experience gains	**(21.9)**	(6.2)
Remeasurement recognised in other comprehensive income	**(86.6)**	49.5

6.8 Notes to the Regulatory Financial Statements
For the year ended 31 March 2016

11. Pension commitments (continued)

Electricity Supply Pension Scheme ("ESPS") (continued)

The movement in the net defined benefit obligation over the accounting period is as follows:

	Year ended 31 March 2016			Year ended 31 March 2015		
	Present value of obligation £m	**Fair of plan assets £m**	**Total £m**	Present value of obligatio £m	Fair of plan assets £m	Total £m
Liability at 1 April	**1,591.7**	**(1,448.1)**	**143.6**	1,379.2	(1,248.6)	130.6
Current service cost	**14.6**	**-**	**14.6**	11.2	-	11.2
Administrative cost	**1.0**	**-**	**1.0**	0.9	-	0.9
Interest expense/(income)	**48.6**	**(44.7)**	**3.9**	58.1	(53.4)	4.7
	64.2	**(44.7)**	**19.5**	70.2	(53.4)	16.8
Remeasurements:						
Loss/(gain) on plan assets excluding amounts included in interest income	**-**	**63.0**	**63.0**	-	(156.0)	(156.0)
Gain from change in demographic assumptions	**(51.1)**	**-**	**(51.1)**	-	-	-
Loss/(gain) from change in financial assumptions	**(76.6)**	**-**	**(76.6)**	211.7	-	211.7
Experience (gains)/losses	**(21.9)**	**-**	**(21.9)**	(6.2)	-	(6.2)
	(149.6)	**63.0**	**(86.6)**	205.5	(156.0)	49.5
Contributions:						
Employer	**-**	**(53.4)**	**(53.4)**	-	(53.3)	(53.3)
Plan participants	**2.7**	**(2.7)**	**-**	2.6	(2.6)	-
	2.7	**(56.1)**	**(53.4)**	2.6	(55.9)	(53.3)
Payments from plan:						
Benefit payments	**(66.0)**	**66.0**	**-**	(64.9)	64.9	-
Administrative costs	**(1.0)**	**1.0**	**-**	(0.9)	0.9	-
	(67.0)	**67.0**	**-**	(65.8)	65.8	-
Liability/(asset) at 31 March	**1,442.0**	**(1,418.9)**	**23.1**	1,591.7	(1,448.1)	143.6

The significant actuarial assumptions made were as follows:

	2016	2015
RPI inflation	**2.65**	2.65
CPI inflation	**1.55**	1.55
Rate of general long-term salary increases	**3.40**	3.90
RPI-linked pension increases	**2.65**	2.65
Post-88 GMP pension increases	**1.55**	1.55
Discount rate for scheme liabilities	**3.36**	3.10

6.8 Notes to the Regulatory Financial Statements
For the year ended 31 March 2016

11. Pension commitments (continued)

Electricity Supply Pension Scheme ("ESPS") (continued)

Assumptions relating to future mortality are set based on actuarial advice in accordance with published statistics and experience. These assumptions translate into an average life expectancy in years for a member at age 60:

	31 March 2016	31 March 2015
Mortality table adopted	Based on S2PXA base tables with CMI 2015 core projections and a 1.0% per annum long-term improvement rate	Based on S1PXA base tables with CMI 2011 core projections and a 1.0% per annum long-term improvement rate
Life expectancy for a male currently aged 60	**26.5**	27.3
Life expectancy for a female currently aged 60	**28.6**	29.8
Life expectancy at 60 for a male currently aged 40	**27.5**	28.5
Life expectancy at 60 for a female currently aged 40	**29.8**	31.0

The sensitivity of the defined benefit obligation to changes in the principal assumptions is:

	Change in assumption %	Impact on defined benefit obligation £m
Discount rate	+/-0.50%	+117.8 / -106.4
RPI inflation	+/-0.50%	+109.0 / -93.6
Life expectancy	+ 1 year	59.8

The above sensitivity analysis on the discount rate is based on a change in assumption while holding all other assumptions constant. The change in RPI inflation assumption impacts on the salary increases, CPI assumption, revaluation in deferment and pension increase assumptions. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions the same method (present value of the defined benefit obligation calculated with the projected unit credit method at the end of the reporting period) has been applied as when calculating the pension liability recognised in the balance sheet.

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

11. Pension commitments (continued)

Electricity Supply Pension Scheme ("ESPS") (continued)

The Central Networks Group of the ESPS scheme assets are comprised as follows:

	31 March 2016		31 March 2015	
	Total	**Of which not quoted in an market**	Total	Of which not quoted in an active market
	£m	**£m**	£m	£m
Global equities	**230.1**	**-**	196.9	-
Global credit	**100.3**	**-**	176.5	-
Property	**98.7**	**98.7**	68.7	68.7
Macro-orientated	**249.9**	**249.9**	242.1	242.1
Multi strategy	**154.0**	**-**	108.1	20.2
LDI strategy	**586.4**	**-**	656.0	-
Other	**(0.5)**	**-**	(0.2)	-
Total	**1,418.9**	**348.6**	1,448.1	331.0

There is no self-investment in the Scheme.

Through its defined benefit pension plan, the Company is exposed to a number of risks, the most significant of which are detailed below:

Asset volatility	The liabilities are calculated using a discount rate set with reference to corporate bond yields; if assets underperform this yield, this will create a deficit. The scheme holds a significant proportion of growth assets (e.g. equities) which are expected to outperform corporate bonds in the long-term while providing volatility and risk in the short-term. The allocation to growth assets is monitored such that it is suitable with the scheme's long-term objectives.
Change in bond yields	A decrease in corporate bond yields will increase the scheme's liabilities, although this will be partially offset by an increase in the value of the scheme's bond holdings.
Inflation risk	The majority of the scheme's benefit obligations are linked to inflation, and higher inflation will lead to higher liabilities (although, in most cases, caps on the level of inflationary increases are in place to protect against extreme inflation). The majority of the assets are either unaffected by or loosely correlated with inflation, meaning that an increase in inflation will increase the deficit.
Life expectancy	The majority of the scheme's obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the liabilities.

The scheme uses government bonds, corporate bonds and cash as matching assets. The remainder of assets are used as growth assets.

The employer has agreed that it will aim to eliminate the scheme actuarial deficit (as assessed on the ongoing funding basis) by 31 March 2022.

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

11. Pension commitments (continued)

Electricity Supply Pension Scheme ("ESPS") (continued)

The current agreed employer contributions are 31.4% per annum of pensionable salaries in respect of future benefit accrual, expenses (including PPF levies) and death in service benefits, and £80m per annum for the Central Networks Group segment as a whole (indexed annually with RPI from April 2015) in respect of deficit recovery contributions.

Funding levels are monitored on a regular basis and the next triennial valuation is due to be completed as at 31 March 2016.

Expected employer contributions to the WPD East Midlands segment of the ESPS for the year ending 31 March 2017 are £54.0m. The results of the actuarial funding valuation as at 31 March 2016 may give rise to a revised schedule of contributions.

The weighted average duration of the defined benefit obligation is around 17 years.

Other scheme

WPD also operates a defined contribution scheme. The assets of the scheme are held separately from those of WPD in an independent fund administered by the scheme trustee. The scheme has two sections:

(a) a closed section with no active members. All of the active members in this scheme have transferred to the ESPS. At 31 March 2016 there were 213 members with deferred benefits in the scheme (2015: 261) and 6 pensioners (2015: 6). Market value of the assets was £1.9m (2015: £2.1m).

(b) a new pension arrangement available to all new employees in WPD with effect from 1 April 2010. At 31 March 2016 there were 3,015 members (2015: 2,203). The market value of the assets of the open section of the scheme was £42.2m (2015: £24.8m). Employer contributions to the scheme across WPD amounted to £5.6m in the year (2015: £4.7m).

12. Directors' emoluments

The service contracts for the executive directors are with WPD South West. However, the emoluments detail given in this note represents total emoluments of the directors for all services provided to WPD companies as a whole. The costs are apportioned between WPD South Wales, WPD South West, WPD West Midlands and WPD East Midlands.

6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

12. Directors' emoluments (continued)

	Highest paid director (note i)		**Total**	
	2016 £000	2015 £000	**2016 £000**	2015 £000
The emoluments of the executive directors comprised:				
Base salary (note ii)	**575**	364	**1,430**	1,406
Performance dependent bonus (note iii)	**489**	272	**1,039**	981
Pension compensation allowance (note iv)	**-**	555	**649**	555
Sub-total directors' remuneration	**1,064**	1,191	**3,118**	2,942
Long term incentive plan (note v)	**751**	547	**1,456**	1,239
Fees to the independent non executive director (note vii)	**-**	-	**60**	60
	1,815	1,738	**4,634**	4,241

(i) In 2016, the highest paid director was the Chief Executive Officer. In 2015, another director was the highest paid.

(ii) Base salary also includes benefits in kind.

(iii) The amount of the annual bonus is based on WPD's financial performance, the reliability of the electricity networks, and other factors.

(iv) In anticipation of the change in tax applicable to UK pensions effective 6 April 2006, the executive directors at that time resigned as active members of the Electricity Supply Pension Scheme ("ESPS" - note 9) on 5 April 2006 and elected for enhanced protection; two remained in service in both years. As a result of the change in tax applicable to UK pensions introduced in the Finance Act 2016, WPD determined that the pension arrangements for the two executive directors who were active members at the start of 2016 should be changed effective 2 March 2016, at which point they resigned as active members. Thus, in respect of all four current executive directors, WPD no longer contributes for ongoing service to the ESPS. Instead, WPD pays cash compensation to them individually equivalent to the value of WPD’s contribution in to the ESPS that would have been made had they remained active members (as determined by external actuaries).

(v) Under a long term incentive plan, annually the executive directors are granted phantom stock options. The option price is set at the quoted share price of WPD's parent in the US, PPL Corporation, at the date the phantom options were granted. Options outstanding may be exercised during fixed periods and the gain is payable through the payroll. The values above include any payments made to the executive directors in respect of gains in value of phantom options exercised in the year. None of the executive directors were granted new options in either year; three executive directors exercised options (2015: four). In addition, the executive directors receive annually a grant of PPL Corporation shares which cannot generally be accessed for 3 years; a number of these shares is dependent on the achievement of certain performance criteria at PPL. The value of the shares granted in the year is shown within this line.

(vi) During the year, four executive directors (2015: five) were members of the defined benefit ESPS of which two (2015: two) were active members until 2 March 2016 (see (iv) above). At 31 March 2016, the highest paid director that year had accrued annual pension benefits of £521,528. The benefits shown assume that an option to convert an element of the annual benefits to a lump sum payable on retirement is not exercised.

6.8 Notes to the Regulatory Financial Statements
For the year ended 31 March 2016

12. Directors' emoluments (continued)

(vii) The two independent UK non-executive directors are entitled to fees as determined by the appropriate Board. No emoluments are paid to US based non executive directors, who are officers of PPL, in respect of their services as directors to the WPD group.

13. Tangible fixed assets

	Non network land & buildings £m	Distribution network £m	Fixtures & equipment £m	Vehicles & mobile plan £m	Total £m
Cost					
At 1 April 2015	0.4	4,351.5	66.2	21.9	4,440.0
Additions	0.6	317.8	9.5	2.8	330.7
Transfer from other WPD undertakings	(0.4)	0.4	-	-	-
Disposals and retirements	-	-	(15.3)	(0.1)	(15.4)
At 31 March 2016	0.6	4,669.7	60.4	24.6	4,755.3
Depreciation					
At 1 April 2015	0.4	1,101.6	26.3	3.4	1,131.7
Charge for the year	-	62.6	13.9	2.7	79.2
Transfer from other WPD undertakings	(0.4)	0.4	-	-	-
Disposals and retirements	-	-	(15.3)	-	(15.3)
At 31 March 2016	-	1,164.6	24.9	6.1	1,195.6
Net book value					
At 31 March 2016	**0.6**	**3,505.1**	**35.5**	**18.5**	**3,559.7**
At 1 April 2015	-	3,249.9	39.9	18.5	3,308.3

The net book value of land and buildings reported within distribution network assets comprises:

	2016 £m	2015 £m
Freehold	**196.9**	158.6

Included within the Company's fixed assets are assets in the course of construction amounting at 31 March 2016 to £42.1m (2015: £27.4m) and land at a cost of £78.1m (2015: £70.1m).

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

14. Intangible assets

	Computer software £m
Cost	
At 1 April 2015	2.2
Additions	1.2
At 31 March 2016	3.4
Amortisation	
At 1 April 2015	1.4
Charge for the year	0.5
At 31 March 2016	1.9
Carrying amount	
At 31 March 2016	**1.5**
At 1 April 2015	0.8

15. Stocks

	2016 £m	2015 £m
Raw materials and consumables	**8.5**	7.8
Work in progress	**0.4**	0.3
	8.9	8.1

16. Debtors

	2016 £m	2015 £m
Amounts falling due within one year:		
Trade debtors	**76.3**	78.4
Amounts owed by other WPD undertakings	**25.5**	2.1
Prepayments and accrued income	**5.8**	7.9
Amounts falling due after more than one year:		
Other debtors	**0.5**	1.1
	108.1	89.5

Amounts owed by other WPD undertakings are unsecured and are repayable on demand.

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

17. Cash and cash equivalents

	2016	2015
	£m	£m
Cash at bank	**0.7**	2.0
Short-term bank deposits	**13.0**	-
Cash and cash equivalents	**13.7**	2.0

At 31 March 2016, the Company had available £300.0m (2015: £300.0m) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met. All facilities incur commitment fees at market rates. WPD West Midlands has a similar £300.0m facility and all four WPD DNOs also have access to an uncommitted facility from which any DNO can draw but which in aggregate cannot exceed £20.0m; no borrowings had been drawn against these facilities as at 31 March 2016 (2015: £nil).

Included in cash and short-term bank deposits are restricted amounts totalling £0.5m (2015: £0.5m) which are not readily available for the general purposes of the Company. The restrictions relate to cash balances that can only be used for Low Carbon Network Fund projects.

For the purposes of the cash flow statement, cash and cash equivalents comprise the following at 31 March:

	2016	2015
	£m	£m
Cash and cash equivalents (from above)	**13.7**	2.0

18. Creditors

	2016	2015
	£m	£m
Amounts falling due within one year:		
Short term borrowing	**-**	**146.0**
Payments received on account	**75.2**	**67.1**
Trade creditors	**17.8**	**15.4**
Amounts owed to other WPD undertakings	**212.3**	**22.0**
UK corporation tax	**8.3**	**12.0**
Other taxation and social security	**13.1**	**13.4**
Other creditors	**14.4**	**0.7**
Deferred contributions	**17.4**	**17.4**
Accruals and deferred income	**35.7**	**65.7**
	394.2	359.7

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

18. Creditors (continued)

	2016	2015
	£m	£m
Amounts falling due after more than one year:		
Deferred contributions	**851.9**	795.4
Unsecured borrowings repayable after more than five years:		
£250m 6.25% bonds 2040	**245.0**	244.8
£700m 5.25% bonds 2023	**701.9**	702.2
£100m 2.671% indexed linked bonds 2043	**110.7**	109.2
£65m 1.676% indexed linked bonds 2052	**124.6**	65.9
	2,034.1	1,917.5

Amounts owed to other WPD undertakings are unsecured and are repayable on demand.

Unsecured borrowings are stated net of unamortised issue costs of £5.3m (2015: £5.5m) and discount on issue of £5.6m (2015: £6.0m) and gross of premium on issue of £22.8m (2015: £7.3m). These costs together with the interest expense are allocated to the profit and loss account over the term of the bonds at a constant rate on the carrying amount.

Interest on bonds is paid semi-annually or annually.

In April and May 2015, WPD East Midlands issued £25.0m and £15.0m aggregate principal amount of 1.676% Index-Linked Senior Notes due 2052. The proceeds were used to reduce bank loans and overdrafts.

Subsequent to the year end, on 24 May 2016, WPD East Midlands entered into a £100m ten year index linked term loan agreement with the Bank of Tokyo-Mitsubishi UFJ, Ltd. The sum was drawn on 31 May 2016.

19. Provisions for liabilities and charges

	Deferred taxation (Note 20)	Asset retirement obligations	Other	Total
	£m	£m	£m	£m
At 1 April 2015	137.3	11.2	4.6	153.1
Arising during the year	18.4	0.1	0.5	19.0
Utilised during the year	-	-	(2.0)	(2.0)
At 31 March 2016	**155.7**	**11.3**	**3.1**	**170.1**

Asset retirement obligations ("AROs") relate to an estimate of the costs of dismantling and removing items of property, plant and equipment at the end of their useful life and are expected to be settled over the next 70 years.

The effect of discounting on AROs is not material and is therefore not shown separately.

Other provisions at 31 March 2016 include £0.5m in relation to clearing a backlog of tree cutting (2015: £2.4m). Other provisions are expected to be utilised within three years.

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

20. Deferred tax

The following are the deferred tax liabilities and assets recognised by the Company and movements thereon during the current and prior year.

	Accelerated capital allowances £m	Retirement benefit obligations £m	Other £m	**Total £m**
At 31 March 2014	166.7	(26.1)	(7.6)	**133.0**
Charge/(credit) to the profit and loss account	10.4	7.3	(3.6)	**14.1**
(Credit)/charge to equity	-	(9.9)	0.1	**(9.8)**
At 31 March 2015	177.1	(28.7)	(11.1)	**137.3**
Charge to the profit and loss account	12.1	6.8	2.0	**20.9**
Change in corporation tax rate	(20.4)	-	0.4	**(20.0)**
Credit to equity	-	17.3	0.2	**17.5**
At 31 March 2016	**168.8**	**(4.6)**	**(8.5)**	**155.7**

Certain deferred tax assets and liabilities have been offset. The following is an analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2016 £m	2015 £m
Deferred tax liabilities	**168.8**	177.1
Deferred tax assets	**(13.1)**	(39.8)
Provision for deferred tax at 31 March	**155.7**	137.3

The net deferred tax liability due after more than one year is £180.0m (2015: £155.4m).

21. Called-up share capital

Allotted, called-up and fully paid:

Ordinary shares of 56 9/11 pence each

	Number	£
At 1 April 2015	206,928,200	117,572,465
Issue of equity shares	52,800,169	30,000,000
At 31 March 2016	**259,728,369**	**147,572,465**

During March 2016 the Company issued 52,800,169 ordinary shares at par to WPD Distribution Network Holdings Limited. The proceeds were used for general corporate purposes.

22. Reserves

	Share premium account £m	Hedging reserve £m	Profit & loss account £m
At 1 April 2014	46.2	(6.0)	536.2
Profit for the financial year	-	-	181.7
Dividends	-	-	(5.7)
Net movement on cash flow hedges (net of tax)	-	0.5	-
Actuarial losses on defined benefit pension plan (net of tax)	-	-	(39.6)
At 31 March 2015	46.2	(5.5)	672.6
Profit for the financial year	-	-	189.2
Dividends paid	-	-	(52.4)
Net movement on cash flow hedges (net of tax)	-	(0.3)	-
Actuarial gains on defined benefit pension plan (net of tax)	-	-	69.5
At 31 March 2016	**46.2**	**(5.8)**	**878.9**

The share premium account arose on the issue of shares under share option schemes prior to acquisition together with the issue of shares to the Company's parent for cash since acquisition.

The hedging reserve relates to the value received in respect of interest rate derivatives entered into in anticipation of the issue of long-term debt. The effective portion of the loss when the swap was cashed out is being amortised through the profit and loss account over the term of the bond.

23. Contingent liabilities

Legal proceedings
WPD East Midlands is party to various legal claims, actions and complaints. Although WPD East Midlands is unable to predict with certainty whether or not it will ultimately be successful in these legal proceedings or, if not, what the impact might be, the directors currently believe that disposition of these matters will not have a materially adverse effect on WPD East Midlands' financial statements.

24. Commitments

Capital commitments
Capital expenditure contracted for at the balance sheet date but not recognised in the financial statements is as follows:

	2016 £	2015 £
Tangible fixed assets	**18.1**	17.1

24. Commitments (continued)

Operating lease commitments - WPD East Midlands as lessee
WPD East Midlands leases various properties under non-cancellable operating lease arrangements. The leases have various terms, escalation clauses and renewable rights. WPD East Midlands also leases plant and machinery under non-cancellable operating leases which are usually very short term.

Future minimum rentals payable under non-cancellable operating leases at 31 March are as follows:

	2016 Land & building £m	**2016 Plant & machinery £m**	2015 Land & buildings £m	2015 Plant & machinery £m
In the first year	**0.2**	**-**	0.1	0.6
In the second to fifth year	**0.6**	**-**	0.5	-
In more than five years	**0.7**	**-**	0.4	-
	1.5	**-**	1.0	0.6

Line losses
During the DPCR4 period, which covered a 5 year period to 31 March 2010, DNOs were subject to a mechanism by which their management of line losses was measured and, depending on their performance, they received either financial incentives or penalties. On 21 March 2014, Ofgem issued its final determination. This increased WPD East Midlands' total liability to approximately £86m. Although the final values had not then been determined, in 2012 Ofgem determined that WPD East Midlands reduce its regulated income for 2013/14 by approximately £44m and the remaining £42m will be refunded to customers during the four years from 1 April 2015.

25. Explanation of transition to FRS 101

For all periods up to and including the year ended 31 March 2015, the Company prepared its financial statements in accordance with previously extant United Kingdom generally accepted accounting practice (UK GAAP). These financial statements, for the year ended 31 March 2016, are the first the Company has prepared under EU-adopted IFRS but follows FRS 101 which allows for reduced disclosure.

Comparative information included in these financial statements has also been prepared in accordance with FRS 101 and the significant accounting policies described in Note 2.

In preparing these financial statements, the Company has started from an opening balance sheet as at 1 April 2014, the Company's date of transition to FRS 101, and made those changes in accounting policies and other restatements required for the first-time adoption of FRS 101. As such, this note explains the principal adjustments made by the Company in restating its balance sheet as at 1 April 2014 prepared under previously extant UK GAAP and its previously published UK GAAP financial statements for the year ended 31 March 2015.

On transition to FRS 101, the Company has applied the requirements of paragraphs 6-33 of IFRS 1 "First time adoption of International Financial Reporting Standards."

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

25. Transition to FRS 101 (continued)

Exemptions Applied

IFRS 1 allows first-time adopters certain exemptions from the general requirements to apply IFRSs. The Company has taken advantage of the following exemptions:

(i) Employee benefits

The Company has elected to recognise all cumulative actuarial gains and losses from employee benefit schemes at the date of transition in retained earnings. All subsequent actuarial gains and losses have been recognised in full in the period in which they occur in the statement of recognised income and expense in accordance with IAS 19, 'Employee Benefits'.

The net defined benefit cost and net deficit of the plan have been allocated to WPD East Midlands and WPD West Midlands in accordance with current pension contributions.

(ii) Tangible fixed assets

The Company has elected to use the previous UK GAAP carrying amount of tangible fixed assets at the date of transition to FRS 101 as deemed cost.

(iii) Business combinations

The Company has elected not to revisit any business combinations prior to 1 April 2014.

Reconciliation of the profit and loss account under UK GAAP to the profit and loss account under FRS 101 for the year ended 31 March 2015

	UK GAAP £m	Income taxes IAS 12 £m	Employe benefits IAS 19 £m	Borrowing costs IAS 23 £m	Other £m	**FRS 101 £m**
Turnover	**469.0**	-	-	-	-	**469.0**
Operating expenses	**(220.2)**	-	39.5	-	(0.5)	**(181.2)**
Operating profit	**248.8**	-	39.5	-	(0.5)	**287.8**
Profit on sale of fixed assets	**0.2**	-	-	-	-	**0.2**
Profit on ordinary activities before interest and tax	**249.0**	-	39.5	-	(0.5)	**288.0**
Interest payable and similar charges	**(61.9)**	-	-	1.5	(0.4)	**(60.8)**
Net interest expense relating to pensions and other post-retirement benefits	-	-	(4.7)	-	-	**(4.7)**
Profit on ordinary activities before tax	**187.1**	-	34.8	1.5	(0.9)	**222.5**
Tax on profit on ordinary activities	**(22.5)**	(11.2)	(7.0)	(0.3)	0.2	**(40.8)**
Profit for the financial year	**164.6**	(11.2)	27.8	1.2	(0.7)	**181.7**

25. Transition to FRS 101 (continued)

Reconciliation of the balance sheet under UK GAAP to FRS 101 as at 1 April 2014 (date of transition to FRS 101)

			IFRS remeasurements/accounting policy alignments			
	UK GAAP	IFRS Reclass-ifications	Income taxes IAS 12	Employe benefits IAS 19	Other	**FRS 101**
	£m	£m	£m	£m	£m	**£m**
Fixed assets						
Tangible assets	**2,220.4**	777.3	-	-	7.1	**3,004.8**
Intangible assets	-	1.2	-	-	-	**1.2**
	2,220.4	778.5	-	-	7.1	**3,006.0**
Current assets						
Stocks	**10.0**	-	-	-	-	**10.0**
Debtors	**124.4**	-	-	(42.3)	-	**82.1**
Cash at bank	**4.1**	-	-	-	-	**4.1**
	138.5	-	-	(42.3)	-	**96.2**
Creditors						
Amounts falling due within one year	**(228.3)**	(17.4)	-	4.0	-	**(241.7)**
Net current liabilities	**(89.8)**	(17.4)	-	(38.3)	-	**(145.5)**
Total assets less current liabilities	**2,130.6**	761.1	-	(38.3)	7.1	**2,860.5**
Creditors						
Amounts falling due after more than one year	**(1,120.2)**	(761.1)	-	-	-	**(1,881.3)**
Provision for liabilities and charges						
Deferred tax	**(83.3)**	-	(84.9)	34.5	0.7	**(133.0)**
Other	**(7.9)**	-	-	-	(10.2)	**(18.1)**
Pension liability	-	-	-	(134.1)	-	**(134.1)**
Net assets	**919.2**	-	(84.9)	(137.9)	(2.4)	**694.0**
Capital and reserves						
Called-up share capital	**117.6**	-	-	-	-	**117.6**
Share premium account	**46.2**	-	-	-	-	**46.2**
Hedging reserve	**(6.0)**	-	-	-	-	**(6.0)**
Profit and loss account	**761.4**	-	(84.9)	(137.9)	(2.4)	**536.2**
Equity shareholders' funds	**919.2**	-	(84.9)	(137.9)	(2.4)	**694.0**

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

25. Transition to FRS 101 (continued)

Reconciliation of the balance sheet under UK GAAP to FRS 101 as at 31 March 2015

			IFRS remeasurements/accounting policy alignments			
	UK GAAP £m	IFRS Reclass-ifications £m	Income taxes IAS 12 £m	Employe benefits IAS 19 £m	Other £m	**FRS 101 £m**
Fixed assets						
Tangible assets	**2,492.6**	812.0	-	(5.2)	8.9	**3,308.3**
Intangible assets	-	0.8	-	-	-	**0.8**
	2,492.6	812.8	-	(5.2)	8.9	**3,309.1**
Current assets						
Stocks	**8.1**	-	-	-	-	**8.1**
Debtors	**128.0**	-	-	(38.5)	-	**89.5**
Cash at bank	**2.0**	-	-	-	-	**2.0**
	138.1	-	-	(38.5)	-	**99.6**
Creditors						
Amounts falling due within one year	**(346.4)**	(17.4)	-	4.1	-	**(359.7)**
Net current liabilities	**(208.3)**	(17.4)	-	(34.4)	-	**(260.1)**
Total assets less current liabilities	**2,284.3**	795.4	-	(39.6)	8.9	**3,049.0**
Creditors						
Amounts falling due after more than one year	**(1,122.1)**	(795.4)	-	-	-	**(1,917.5)**
Provision for liabilities and charges						
Deferred tax	**(79.0)**	-	(96.1)	37.4	0.4	**(137.3)**
Other	**(4.6)**	-	-	-	(11.2)	**(15.8)**
Pension liability	-	-	-	(147.5)	-	**(147.5)**
Net assets	**1,078.6**	-	(96.1)	(149.7)	(1.9)	**830.9**
Capital and reserves						
Called-up share capital	**117.6**	-	-	-	-	**117.6**
Share premium account	**46.2**	-	-	-	-	**46.2**
Hedging reserve	**(5.5)**	-	-	-	-	**(5.5)**
Profit and loss account	**920.3**	-	(96.1)	(149.7)	(1.9)	**672.6**
Equity shareholders' funds	**1,078.6**	-	(96.1)	(149.7)	(1.9)	**830.9**

25. Transition to FRS 101 (continued)

Notes to balance sheet reclassifications

Certain balance sheet balances previously reported under UK GAAP have been reclassified to comply with the format of the Company financial statements presented under FRS 101. The reclassifications below do not have any effect on the Company's previously reported net income, net assets or shareholders' funds.

(i) Computer software

Under UK GAAP, software is capitalised together with the related hardware within tangible fixed assets. Under IFRS, only computer software that is integral to a related item of hardware should be included in tangible fixed assets. All other computer software should be recorded as an intangible asset. At 1 April 2014 £1.2m was reclassified to intangible assets. At 31 March 2015 the reclassification had decreased to £0.8m.

(ii) Customer contributions

Under UK GAAP customer contributions towards distribution network assets, which include Low Carbon Network Funding and capital grants, were credited to the profit and loss account over the estimated useful lives of the related assets. The unamortised amount of such contributions were shown as a deduction from fixed assets. This was a departure from the Companies Act 2006 requirements which requires fixed assets to be included at their purchase price or production cost. The Company decided that as contributions relate directly to the cost of the fixed assets used in the distribution network the treatment adopted was necessary to give a true and fair view.

Under FRS 101 unamortised customer contributions must be shown as deferred income within liabilities, with the amount due to be amortised in the following year shown as short-term and the remainder as long-term.

At 1 April 2014 £778.5m has been reclassified into deferred income, of which £17.4m falls due within one year. At 31 March 2015 £812.8m has been reclassified, of which £17.4m falls due within one year.

Notes to IFRS remeasurements and accounting policy alignments

(i) Deferred tax

Under UK GAAP, deferred tax is provided on timing differences whereas, under IAS 12 'Income Taxes', provision must be made based on temporary differences between carrying values and the related tax base of assets and liabilities, except in certain circumstances.

Under UK GAAP, the Company's policy was to recognise deferred tax on a discounted basis. Under IFRS, this is not permitted and the deferred tax provision has been restated accordingly. This is of particular significance to a utility business where a reversal of timing differences is likely to be deferred long into the future due to the long asset lives of network assets. The inability to discount results in an increase in the balance sheet deferred tax liability of £96.1m at 31 March 2015 and consequently a reduction in net assets. The equivalent adjustment at 1 April 2014 was £84.9m.

The deferred tax impacts arising from other IFRS adjustments are included in the relevant sections.

(ii) Employee benefits

The Company is a member of a group defined pension plan that shares risks between entities under common control (the Central Networks segment to the Electricity Supply Pension Scheme).

25. Transition to FRS 101 (continued)

Notes to IFRS remeasurements and accounting policy alignments (continued)

(ii) Employee benefits (continued)

Under UK GAAP, in respect of the ESPS pension scheme, the Company took advantage of an exemption which enabled companies within a group to account for a defined benefit pension scheme as if it were a defined contribution scheme, recognising a cost equal to their contributions payable for the period. The exemption applied to group companies that were unable to identify their share of the underlying assets and liabilities in the scheme on a consistent and reasonable basis.

IAS 19 removes the group pension exemption resulting in that element of the ESPS scheme deficit which in the judgement of the directors relates to the Company being recognised in the balance sheet, the profit and loss account recognising the current service costs and net finance cost associated with the same element of the ESPS scheme and any actuarial and other gains and losses being recorded in other comprehensive income. Contributions paid are now offset against the liability recorded.

In forming the judgement as to the value to be recorded in the Company in respect of the ESPS scheme, the directors have applied the terms of IAS 19, which state that if the group has a contractual arrangement or stated policy for charging the net defined benefit cost of the plan to individual group entities, each entity recognises the net benefit cost so charged in its individual financial statements. If there is no such agreement or policy, the net defined benefit cost is recognised in the individual financial statements of the group entity that is legally the sponsoring employer of the plan. The other group entities recognise a cost equal to their contribution payable for the period in their financial statements.

The Company does not have an existing stated policy or contractual arrangement for charging pension costs to group entities. Therefore, under FRS 101, the ESPS scheme has been accounted for as a defined benefit scheme by the Company and WPD West Midlands as they have legal responsibility for the plan. The net defined benefit cost and net deficit of the plan have been allocated to WPD East Midlands and WPD West Midlands in accordance with pensionable salaries.

At 31 March 2015 and 1 April 2014, the Company's allocation of the net deficit of the plan was £143.6m and £130.6m respectively. The difference between contributions paid (net of capitalisation) and the defined benefit accounting recorded in the profit and loss was a reduction in expense of £34.8m (before tax) under FRS 101 for the year to 31 March 2015.

As a result of the above the following adjustments have been recorded:

To recognised the ESPS pension scheme a pension liability of £130.6m at 1 April 2014 and £143.6m at 31 March 2015 has been recorded. As a consequence, the unamortised balance of prepaid pension contributions of £38.5m at 31 March 2015 (£42.3m at 1 April 2014) and an accrual for early retirement deficiency costs of £0.2m at 31 March 2015 (£0.5m at 1 April 2014), previously recorded under UK GAAP, have been removed from debtors and creditors amounts falling due within one year, respectively. In addition, unfunded pension obligations of £3.9m at 31 March 2015 (£3.5m at 1 April 2014) have been reclassified from creditors amounts falling due within one year to pension liabilities. Operating profit for the year ended 31 March 2015 has been increased by £39.5m, as contributions (net of £13.0m capitalisation) of £44.5m have been replaced by a current service cost of £12.8m of which £7.8m has been capitalised. The change in capitalisation has resulted in a net reduction of £5.2m to tangible fixed assets at 31 March 2015.

25. Transition to FRS 101 (continued)

Notes to IFRS remeasurements and accounting policy alignments (continued)

(ii) Employee benefits (continued)
Net interest expense on pensions and other post-retirement benefits have increased by £4.7m in relation to the ESPS scheme.

Deferred tax of £34.5m at 1 April 2014 and £37.4m at 31 March 2015 has been recognised in connection with the ESPS scheme deficit. The deferred tax charge in the profit and loss account increased by £7.0m and the deferred tax credit in other comprehensive income increased by £9.9m for the year to 31 March 2015.

(iii) Borrowing costs
Under UK GAAP the Company elected not to capitalise borrowing costs. However, IAS 23 'Borrowing Costs' requires the capitalisation of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset.

The impact of this increases profit before tax for the year to 31 March 2015 and the net book value of fixed assets at that date by £1.5m compared with UK GAAP. Deferred tax of £0.3m has been provided on this adjustment.

(iv) Asset retirement obligations
Included within the 'other' column are amounts in relation to asset retirement obligations ("AROs").

In parallel to the transition process to FRS 101, the Company has aligned its accounting policy for AROs with that of the WPD Group. Under the WPD Group, and the Company's new accounting policy, a liability for the retirement of an asset ("ARO liability") is recognised based on the net present value of the cost of retiring the asset, and at the same time an equal asset is recognised with a matching asset included within tangible fixed assets ("ARO asset"). The ARO asset is depreciated based on the useful life of the underlying asset to which the retirement obligation relates. The discount applied to the ARO liability is unwound over the life of the asset with the resulting increase in the liability charged to the profit and loss account as a finance cost.

Previously, the Company did not recognise any provision for asset retirement as the net obligation was not considered significant to the financial statements.

The impact of adopting the revised policy above is an increase in the net book value of tangible fixed assets of £7.1m at 1 April 2014 and £7.4m at 31 March 2015, the recognition of an ARO liability of £10.2m at 1 April 2014 and £11.2m at 31 March 2015 and a reduction in profit for the year ended 31 March 2015 of £0.9m, comprising £0.5m of depreciation on the ARO asset and £0.4m in respect of the unwind of the discount on the ARO liability. The impact of deferred tax on this adjustment is a £0.7m reduction to the deferred tax liability at 31 March 2015 (£0.7m at 1 April 2014) and a reduction of £0.2m in the deferred tax charge in the profit and loss account for the year ended 31 March 2015.

26. Subsequent event

Subsequent to the year end, on 24 May 2016, WPD East Midlands entered into a £100m ten year index linked term loan agreement with the Bank of Tokyo-Mitsubishi UFJ, Ltd. The sum was drawn on 31 May 2016.

6.8 Notes to the Regulatory Financial Statements

For the year ended 31 March 2016

27. Ultimate parent undertaking

The immediate parent undertaking of the Company is WPD Distribution Networks Holdings Limited, which is registered in England and Wales.

The smallest group in which the results of the Company are consolidated is headed by Western Power Distribution plc. Copies of these financial statements may be obtained from the Company's registered office as stated below.

The largest group in which the results of the Company are consolidated is that headed by PPL Corporation, which is the ultimate parent undertaking. Copies of their accounts may be obtained from Two North Ninth Street, Allentown, Pennsylvania, PA18101-1179, US.

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