



SCOTTISHPOWER

SCOTTISH POWER UK PLC
ANNUAL REPORT AND ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2018

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Some of the statements contained herein are forward looking statements about Scottish Power UK plc and its subsidiaries, and Iberdrola, S.A.'s strategic plans. Although Scottish Power UK plc and Iberdrola, S.A. believe that the expectations reflected in such statements are reasonable, the statements are not guarantees as to future performance and undue reliance should not be placed on them.

STRATEGIC REPORT

The directors present an overview of Scottish Power UK plc's structure, 2018 performance and strategic outlook including principal risks and uncertainties.

SCOTTISH POWER UK PLC GROUP

STRATEGIC OUTLOOK AND 2018 PERFORMANCE

Scottish Power UK plc ("the company"), registered company number SC117120, principally acts as the holding company of the Scottish Power UK plc group ("the group"), whose activities comprise the generation, transmission and distribution of electricity, energy management and the supply of electricity and gas principally in the United Kingdom ("UK"). The three businesses operated by the group during the year were Energy Networks, Renewables and Energy Wholesale and Retail. The company is a wholly owned subsidiary of Iberdrola, S.A. ("Iberdrola"), one of the largest utility companies in the world and the top renewable energy producer in Europe.

Scottish Power Limited is the UK holding company of Scottish Power Limited group ("ScottishPower") of which the company is a member.

On 16 October 2018, the group agreed to sell the ScottishPower Generation group ("Generation") to Drax Smart Generation HoldCo Limited for a consideration of £689 million which includes the sale of four Combined Cycle Gas Turbine ("CCGT") power stations as well as pumped storage and hydro assets. The sale, which completed on 31 December 2018, means that all of the group's generation capacity is now from renewable energy sources.

With its exit from thermal generation, the group is now focusing its strategy on creating a better future, quicker through delivery of a clean low-carbon system for the UK. The group's objectives include:

- investing in networks to make them smarter, more resilient and to create a platform for the UK's sustainable electric future;
- investing in renewable energy, particularly onshore and offshore wind, to tackle climate change and reduce the cost of electricity generation;
- creating a fairer and more transparent market where customers are in control of their energy usage through digitisation and smart metering; and
- designing and delivering an energy system to facilitate and encourage the growth of electric vehicles to improve air quality and tackle climate change.

The recent Intergovernmental Panel on Climate Change ("IPCC") report highlights the challenge and urgency of reducing carbon emissions cost-effectively and the group strongly welcomes the UK, Scottish and Welsh governments asking the Committee on Climate Change for its advice on a net-zero emission target.

The UK Government has confirmed that an allocation of up to £60 million of funding will be available for a Contracts for Difference ("CfD") auction planned for May 2019, which will provide opportunities for new offshore wind and certain other 'less established' renewable technologies. Whilst no commitment has as yet been made by the UK Government to offer CfD support for onshore wind in the future, UK Ministers continue to recognise it is an important part of the low carbon generation mix. In Networks, in July 2018, the Office of Gas and Electricity Markets ("Ofgem") confirmed the overall framework for the second round of price controls based on the Revenue = Incentives + Innovation + Outputs ("RIIO") regime and in December 2018 published a consultation on the RIIO-T2 price control for transmission networks. The ScottishPower/National Grid High Voltage Direct Current ("HVDC") link is the highest capacity HVDC cable in the UK and has increased the capacity of electricity flowing between Scotland and England/Wales by more than 2 gigawatts ("GW"). The link normally operates in a north to south configuration in line with the economics that underpinned the investment, and is available to be used by National Grid System Operator in the south to north configuration in particular circumstances. In July 2018, the Domestic Gas and Electricity (Tariff Cap) Act received Royal Assent requiring Ofgem to place a cap on rates charged for the supply of gas and electricity to domestic customers on default tariffs. In November 2018, Ofgem confirmed a default dual fuel tariff cap would come into effect on 1 January 2019 for an initial two year period. Ofgem set the level of the cap at £1,137 (for dual fuel customers with typical consumption paying by Direct Debit) for the period January to March 2019. On 7 February 2019, Ofgem announced an update to the level of the price cap. From 1 April 2019, the level of the cap was set at £1,254, an increase of £117 from the previous level.

In Scotland, the Scottish Government focused on its 'Programme for Government' in 2018. This included a new commitment to establish a statutory consumer body and a continued focus on promoting electric vehicle ("EV") uptake. A second independence referendum before the next Scottish Parliament election in 2021 is unlikely but not ruled out entirely. The Scottish Government intends to set out its forward position when the terms of Brexit are clearer.

Looking forward, the group will continue to invest £4.6 billion in the UK until 2022 in an operating environment that looks set to remain challenging. The macro-economic situation in the UK remains relatively stable but with significant adverse Brexit risks. The group is engaging with the UK Government to help shape the future of energy policy.

The group's strategy is to focus investment in networks, renewable energy generation, and retail to help its customers realise a better future, quicker:

- The group will continue to invest in transmission and distribution networks, to ensure all customers have the power they need as set out in its RIIO-1 business plan. In December 2018, Ofgem published its sector specific consultation for the next round of RIIO-2 price controls consultation which includes further developments, such as in relation to the cost of capital and incentives. Companies are due to submit their final business plans to Ofgem in late 2019.
- With the cost of renewable generation continuing to fall, the group has a significant opportunity to extend its current operations in onshore and offshore wind, as well as investing in battery storage. The group is planning to bid to secure a CfD for the East Anglia Three project in May 2019, with the first export from the East Anglia One project expected towards the end of 2019. The group will also consider opportunities to invest more widely in renewable generation, including solar.
- In Retail, the introduction of the price cap from 1 January 2019 until the end of 2020 (extendable on an annual basis until 2023) is likely to affect the mix of tariffs in the market including fixed period tariffs. The group will continue to engage with customers to help ensure they are on the best deal for them. As the smart meter roll out continues, the group will explore opportunities to offer customers a wider range of products to help them control their energy usage consistent with their lifestyle.
- The group will also seek commercial opportunities across its businesses to offer products and services as the electrification of transport increases at pace. This will include further development of a domestic retail offer following the launch of the partnership with Arnold Clark in November 2018; as well as considering market opportunities for public charging. Energy Networks will continue to engage with governments and regulators on the progress of the reinforcement of the network required to sustain the growth of EVs.

STRATEGIC REPORT *continued*

SCOTTISH POWER UK PLC GROUP *continued*

STRATEGIC OUTLOOK AND 2018 PERFORMANCE *continued*

The table below provides key financial information relating to the group's performance during the year. Further detail is provided in the individual business sections of the Strategic Report.

Financial key performance indicators ("KPIs")	Revenue*		Operating profit*		Capital investment	
	2018 £m	2017** £m	2018 £m	2017** £m	2018 £m	2017 £m
Continuing operations – Scottish Power UK plc group	4,993.7	4,881.3	941.8	652.6	1,132.8	1,676.5

* The group's revenue and operating profit from continuing operations as presented on page 32.

** Restated (refer to Note 2).

In the financial year revenues have increased by £112 million. Operating profit for the financial year was £942 million, an increase of £289 million. This increase mainly reflects the £187 million recovery of the Energy Wholesale and Retail business due to higher Retail gross margins in addition to lower operating costs and depreciation. Operating profit in the Renewables business also increased by £81 million reflecting increased average operating capacity.

The group's continued commitment to the UK energy market is reflected by capital investment of £1.1 billion in 2018, which is largely consistent with underlying 2017 spend. 2017 included £353 million of capital expenditure on offshore wind projects in France and Germany which have now been transferred to a related company within the Iberdrola group (refer to Note 34). Underlying capital investment has reduced by £139 million, primarily due to decreased spend in SP Transmission plc ("SPT") as some major projects near their end.

ENERGY NETWORKS

BUSINESS DESCRIPTION AND OUTLOOK

Energy Networks owns three regulated electricity network businesses in the UK. These businesses are 'asset-owner companies', holding the regulated assets and Electricity Distribution and Transmission Licences of the group, and are regulated monopolies. They own and operate the network of cables and power lines transporting electricity to around 3.5 million connected customers in the South of Scotland, Cheshire, Merseyside, North Shropshire and North Wales.

One of the regulated businesses, SPT is a transmission network owner. The electricity transmission network consists of the high voltage electricity wires that convey electricity from power stations to distribution system entry points or, in certain cases, direct to end users' premises via a national network of high voltage assets.

The other two regulated businesses are Distribution Network Operators ("DNO"): SP Distribution plc ("SPD") and SP Manweb plc ("SPM"). The electricity distribution networks are regional grids that transport electricity at a lower voltage from the national transmission grid and embedded generators and connect to industrial, commercial and domestic users.

All three regulated businesses are natural monopolies and are governed by Ofgem via regulatory price controls. The primary objective of the regulation of the electricity networks is the protection of consumers' interests while ensuring that demand can be met and companies are able to finance their activities. Price controls are the method by which the amount of allowed revenue is set for network companies over the period of the price control. Price control processes are designed to cover each company's efficient costs and allow them to earn a reasonable return, provided they act in an efficient manner, deliver value for customers and meet Ofgem targets.

Up to 31 December 2017, SP Power Systems Limited ("Power Systems"), an unregulated business, provided asset management expertise and conducted the day-to-day operation of the networks. Along with the asset-owner companies it acted as an integrated business unit to concentrate expertise on regulatory and investment strategy with Power Systems implementing programmes commissioned by and agreed with the asset-owner companies. Strict commercial disciplines were applied at the asset-owner service provider interface, with Power Systems operating as a contractor to the distribution and transmission businesses. From 1 January 2018, the role of Power Systems changed and it now provides a narrower range of asset management support services as opposed to being an internal contractor delivering work programmes. A new Network Asset Management System was introduced in 2018. This more fully utilises functionality within Energy Networks' existing SAP enterprise resource planning system. Key improvements targeted include standardised and streamlined business processes alongside automated work management and reporting.

The second round of RII0 price controls (RII0-2) will begin in 2021 for the transmission business and in 2023 for the distribution business. In July 2018, Ofgem published its RII0-2 Framework decision which included high level decisions on particular elements of the price control framework. Alongside this document, Ofgem also published a report by Cambridge Economic Policy Associates, a consulting firm setting out its initial cost of capital ranges, which will not be finalised until Ofgem's final transmission price determination in 2020. In December 2018, Ofgem published its RII0-2 sector specific consultation which includes further price control developments, such as the cost of capital and incentives. Companies are due to submit their final business plans to Ofgem in late 2019.

SPT remains on track to complete an ambitious eight year RII0-T1 programme of network renewal, which has two years remaining. At December 2018, the company is almost 75% through its overhead line replacement programme of approximately 800 km, which is over 200 km ahead of plan. Other major deliverables include the connection of an additional 1,449 megawatts ("MW") of directly connected generation, completion of two significant overhead line routes utilising innovative composite-core 'High Temperature Low Sag' technology and completion of a cumulative 65% of non-load outputs, ahead of the RII0-T1 plan of 60% for the first six years.

In February 2012, National Grid and SPT announced the award of a £1 billion contract to build the first ever sub-sea electricity link between Scotland and England/Wales. As previously mentioned, the HVDC link is the highest capacity HVDC cable in the UK and has increased the capacity of electricity flowing between Scotland and England/Wales by more than 2 GW. The link normally operates in a north to south configuration in line with the economics that underpinned the investment, and is available to be used by National Grid System Operator in the south to north configuration in particular circumstances.

In March 2018, Energy Networks announced the launch of a Green Economy Fund. Working alongside the Scottish Government, Ofgem and independent economic advisors, funding will be made available for initiatives focused on delivering low carbon transport and heating. The Fund aims to further Scotland's ambitious green energy plans and at the same time create economic growth opportunities for local communities.

STRATEGIC REPORT *continued*

ENERGY NETWORKS *continued*

BUSINESS DESCRIPTION AND OUTLOOK *continued*

Energy Networks has recently achieved important milestones towards the goal of being a recognised leader in asset management. These include the signature of a corporate partnership with the Institute of Engineering and Technology ("IET") and Energy Networks' leading role in this year's CIRED (Congress International de Reseaux Electriques) conference in Glasgow, where Energy Networks set out the vision for evolution to a Distribution System Operator ("DSO").

During 2018, Energy Networks also won a number of awards:

- At the Young Professionals Green Energy Awards 2018, three Energy Networks employees won awards for Innovation, Achievement and a Special Commendation award.
- SPD received the BSI Kite Mark Certification for Customer Service after completing a seven day audit. Energy Networks is the first utility in the world to have achieved this new standard.
- The LV ("Low Voltage") Engine project won the annual WSP Project Award for Scotland and North England in the Sustainability Category. LV Engine is a Network Innovation Competition ("NIC") project funded by Ofgem which will build and test a number of smart transformers for use within secondary substations.
- An Energy Networks apprentice was awarded the Rising Star award at the National Skills Academy for Power's annual award ceremony held in September 2018.
- Energy Networks received three awards at the Utility Week Stars Award 2018 event. The Energy Networks employees received the awards in the categories of Rising Star, Guiding Star and Hero Team.

In line with the group's strategic objectives and its regulatory obligations, Energy Networks is maintaining its significant investment in the UK energy network. Over the last ten years, Energy Networks has invested around £5.6 billion in its transmission and distribution networks, and during the next ten years, plans to invest a further £5.4 billion to modernise and improve service to customers. Energy Networks' ten year investment plans are reviewed annually in detail to ensure plans are aligned with and continue to support UK Government energy policy.

In 2017, both the Scottish and UK Governments outlined plans to limit the purchase of new diesel or petrol vehicles after 2032 and 2040 respectively. To enable the wide scale roll out of EVs, it is key that the UK's electricity networks can facilitate suitable charging infrastructure for customers at a reasonable cost. Energy Networks will be engaging with a range of stakeholders to understand the capabilities of EV products and thereby understand the potential impact on customers' electrical needs.

The Electricity Network Association's ("ENA") previously launched Open Networks project lays the foundations of a smart energy grid in the UK. The project brings together the UK energy industry as well as leading academics, trade associations and non-governmental organisations and aims to transform the way networks work. The project will enable the UK's energy networks companies to move from the traditional role of delivering electricity in one direction from centralised power plants to homes and communities, to one where the network acts as a smart platform that enables a whole range of new energy technologies that generate, consume and manage electricity. The project is a key tool to support Energy Networks' vision of how it can transition from a traditional DNO role to that of a DSO.

Energy Networks has joined with four other UK DNOs to trial the Piclo Flex online marketplace in an effort to discover where flexibility can be used as an effective alternative to traditional reinforcement in congested network areas. The trial is designed to provide key results that will inform, complement and support Energy Networks' £6 million smart energy platform Fusion, which the business launched in Q4 2017.

Energy Networks is mindful that some of its assets are critical national infrastructure. Energy Networks liaises with UK Government agencies to ensure that any potential threats and risks are assessed and mitigated. Energy Networks takes steps to enhance both the physical security of its assets and the security of its associated IT and communications systems in circumstances where potential risks are identified.

Announcements in the past few years by the UK Government on funding programmes have led to some renewables developers scaling back future activity. Some developers have requested acceleration in connection dates, while other projects have been deferred or cancelled. These developments have been analysed carefully, resulting in updated projections of volumes and expenditure for the Energy Networks business. The external environment will continue to be monitored and the impact of any changes in trends will be considered in future forecasts. Investments in electricity transmission assets which facilitate bulk energy transfer across the UK, for which the ability to export energy from Scotland was previously the main driver, have become important to ensure security of supply in Scotland through import capability, in light of existing and planned large generation plant closures on both sides of the Anglo-Scottish border. Energy Networks remains engaged with the UK Government, Scottish Government, National Grid and other industry stakeholders on issues related to ensuring resilience and security of supply in Great Britain.

In July 2018, Energy Networks was awarded the full Successful Delivery Reward of £1.6 million future revenue funding for project ARC (Accelerating Renewable Connections) and project VISOR (Visualisation of Real Time System Dynamics using Enhanced Monitoring) reflecting successful delivery of two flagship innovation projects under the Ofgem NIC. These projects were both about releasing capacity in the transmission and distribution network to enable renewable generation to connect faster and at a lower cost while maintaining network security and stability. Both of these projects were completed on time and below budget while over-delivering on project outputs.

Looking ahead, Energy Networks will continue to play a part in the roll out of smart meters. In some properties there is a requirement to upgrade Energy Networks' assets to enable the fitting of a smart meter or to respond to an emergency situation. Such interventions may continue to be required in greater numbers than previously forecast by the industry. As the deployment of smart metering increases, plans have been updated to ensure resource levels are adequate to meet the challenge.

The impact of Brexit on Energy Networks is considered on pages 9 and 10 of the Strategic Report.

STRATEGIC REPORT *continued*

ENERGY NETWORKS *continued*

2018 OPERATIONAL PERFORMANCE

Financial key performance indicators ("KPIs")	Revenue *		Operating profit **		Capital investment ***	
	2018 £m	2017**** £m	2018 £m	2017 £m	2018 £m	2017 £m
Continuing operations – Energy Networks	1,167.4	1,106.3	545.9	538.9	594.3	732.6

* Segment total revenue as presented in Note 4 on page 52.

** Segment operating profit as presented in Note 4 on page 53.

*** Segment capital investment as presented in Note 4 on page 55.

**** Restated (refer to Note 2).

Energy Networks' revenue is £61 million higher than the prior year. Allowable transmission revenues have increased under RIIO-T1 by £31 million. Distribution revenues have increased by £30 million mainly due to base revenues allowed under RIIO-ED1.

Operating profit increased by £7 million to £546 million in 2018, due to higher revenues partially offset by increased overheads and property taxes as well as increased depreciation charges of £30 million reflecting continued levels of investment.

Energy Networks' capital investment decreased by £138 million to £594 million in 2018, primarily due to decreased spend in SPT as some major projects near their end.

The three regulated businesses within Energy Networks are required to prepare regulatory accounts for the years ending 31 March. Reporting of key performance indicators is aligned to the regulatory year end. Consequently, the latest available data for the last regulatory year for Energy Networks has been disclosed in the table below, with the exception of distributed energy that is reported for the years ending 31 December.

Non-financial key performance indicators ("KPIs")	Notes	Actual 2018	Target 2018	Actual 2017	Target 2017
Distributed energy (GWh)					
- SPD		17,547	N/A	17,749	N/A
- SPM		14,913	N/A	15,023	N/A
Customer interruptions	(a)				
- SPD		41.3	51.6	42.9	51.9
- SPM		30.6	37.6	38.2	38.1
Customer minutes lost	(b)				
- SPD		31.2	44.8	29.3	45.7
- SPM		33.1	42.4	37.3	44.2
Customer Performance:	(c)				
Broader customer service measure – Interruptions					
- SPD		8.82	8.20	8.74	8.20
- SPM		8.86	8.20	8.74	8.20
Broader customer service measure – Connections					
- SPD		8.52	8.20	8.43	8.20
- SPM		8.43	8.20	8.68	8.20
Broader customer service measure – General enquiries					
- SPD		8.95	8.20	9.05	8.20
- SPM		9.39	8.20	9.30	8.20
Energy ombudsman (Customer complaints)	(d)				
- SPD		2	–	5	–
- SPM		3	–	2	–
Transmission operational performance (Incentivised incidents)	(e)				
- SPT		2	–	4	–

* Gigawatt hours ("GWh")

(a) Customer interruptions are reported as the number of customers, per 100 customers, that are affected during the year by power cuts that last three minutes or more.

(b) Customer minutes lost is reported as the average number of minutes that a customer is without power during a year due to power cuts that last three minutes or more.

(c) Broader customer service measures are assessed using the following three methods: a customer satisfaction survey, complaints metric and stakeholder engagement.

(d) The Energy Ombudsman Services, an independent body, monitors and adjudicates complaint cases.

(e) Transmission operational performance is reported as the number of 'energy not supplied' and associated incidents. These incentivised incidents are incidents where the loss of supply is longer than three minutes.

Energy Networks is committed to maintaining high performance during extreme weather events. Consequently, during the course of the year £38 million was invested to refurbish or rebuild sections of the overhead line network. In addition £3 million was invested in tree cutting activities.

Both of these investments have contributed significantly to improving the performance of distribution assets during storms.

RENEWABLES

BUSINESS DESCRIPTION AND OUTLOOK

ScottishPower Renewables ("Renewables") is responsible for the origination, development, construction and operation of renewable energy generation plants, predominantly onshore wind, with a large and growing presence in offshore wind, and the consideration of emerging renewable technologies and innovations such as battery storage. Renewables continues to engage with the UK Government on plans for future investments in renewable generation and the electricity system, including flexibility and energy storage.

Renewables has a successful track record as a developer of onshore wind farms with a conversion rate of megawatt capacity from planning to consent of over 90%. The business is the leading developer of onshore wind farms in the UK with a current onshore operating capacity of over 1,900 MW.

Renewables continues to explore development opportunities for further growth of onshore wind. Renewables has also published a number of reports in 2018 highlighting the cost of capital benefits of a market stabilisation CfD supporting the delivery of low cost green, clean power to consumers and another presenting the economic, employment and industrial benefits to the UK of future onshore wind deployment. Renewables believes that a government-facilitated competitive CfD auction could provide the optimal route to market for the most cost-effective electricity for consumers across Great Britain. Renewables is therefore actively involved in a number of power purchase agreement ("PPA") processes to provide this cost-effective energy to business customers.

As previously mentioned, whilst UK Ministers continue to recognise onshore wind is an important part of a low carbon generation mix, the ongoing challenging political climate means it is unlikely there will be any change allowing onshore wind to participate in CfD auctions any time soon. Government advisers, including the Committee on Climate Change and the National Infrastructure Commission, have also highlighted the importance of low cost options, such as onshore wind, as part of the low carbon generation mix if future carbon reduction targets are to be achieved. Renewable generation technologies continue to innovate and this has resulted in substantial cost reduction in recent years for both onshore and offshore wind, as well as Solar Photovoltaic ("PV").

Renewables is also a leading developer and operator of offshore wind in the UK. The 389 MW West of Duddon Sands ("WODS") project in the East Irish Sea is a 50/50 joint arrangement with Orsted West of Duddon Sands (UK) Limited. Availability in 2018 was in line with expectations. Following the £2.5 billion Final Investment Decision ("FID") for its 714 MW East Anglia One project in early 2016, construction is currently underway, with first export scheduled towards the end of 2019. In August 2017, Renewables also received consent from the Secretary of State for Business Energy and Industrial Strategy ("BEIS") for its 1.2 GW East Anglia Three ("EA3") offshore wind project and continues to make progress in relation to the remainder of the East Anglia Zone, with around 1.7 GW of projects at various stages of development. Energy and Clean Growth Minister, Claire Perry confirmed in July 2018 that a pipeline of auctions for 'less established' renewable technologies (including offshore wind) would be forthcoming, using the £557 million previously announced for CfD auctions, with a first auction opening in May 2019, and auctions taking place around every two years thereafter. EA3 plans to participate in the May 2019 auction.

In November 2018, BEIS published the draft Budget and Administrative Strike Prices ("ASPs") for the next CfD auction. BEIS intends to release up to £60 million (in 2012 prices) for projects with target commissioning dates in 2023/24 and 2024/25, with ASPs for offshore wind of £56 per megawatt hour ("MWh") and £53/MWh respectively (2012 prices). BEIS is confident that this is consistent with its ambition to deliver 1-2 GW of offshore wind per year in the 2020s.

The UK Government's commitment to proceed with the 2019 CfD process for 'less established' renewable technologies follows the second CfD allocation round of September 2017 which delivered strike prices for projects set to deliver in 2022/23 at £57.50/MWh (2012 prices); a 50% reduction against the previous CfD auction held in 2015.

The UK Treasury's 2017 Autumn Budget introduced a new Control for Low Carbon Levies which set out that there would be no new funds for CfDs (beyond the £557 million referred to above) until the overall burden of low carbon generation support costs started to fall (probably after 2025 based on current forecasts). However, given the strike price achieved in the 2017 auction, the remaining £557 million could fund a large programme of renewables in the years to come.

The impact of Brexit on the Renewables business is considered on pages 9 and 10 of the Strategic Report.

2018 OPERATIONAL PERFORMANCE

Financial key performance indicators ("KPIs")	Revenue *		Operating profit **		Capital investment ***	
	2018 £m	2017 £m	2018 £m	2017 £m	2018 £m	2017 £m
Continuing operations – Renewables	540.3	473.2	271.7	190.5	346.3	737.7

* Segment total revenue as presented in Note 4 on page 52.

** Segment operating profit as presented in Note 4 on page 53.

*** Segment capital investment as presented in Note 4 on page 55.

Renewables revenue increased by £67 million to £540 million in 2018 reflecting higher energy and Renewable Obligations Certificate ("ROC") prices as well as higher electricity output of 390 GWh as a result of increased average operating capacity.

Operating profit increased by £81 million to £272 million in 2018. In addition to the positive earnings impact from the higher operating capacity, the business benefited from the receipt of various insurance and liquidated damages claims totalling £29 million.

Capital investment decreased by £391 million to £346 million in 2018. UK based capital investment in onshore and offshore projects decreased by £38 million. Investment outside the UK decreased by £353 million (refer to Note 34).

Non-financial key performance indicators	Notes	2018	2017
Plant output (GWh)	(a)	4,568	4,178
Installed Capacity (MW)	(b)	2,100	2,100
Availability	(c)	96%	95%

(a) Plant output is a measure of the electrical output generated in the year, which in turn drives the revenues of the business.

(b) Installed capacity represents the total number of MW fully installed within the wind farm sites. This includes all turbines erected irrespective of whether they are generating or not.

(c) Availability is a measure of how effective the business is at ensuring wind generating plant is available and ready to generate.

STRATEGIC REPORT *continued*

ENERGY WHOLESALE AND RETAIL

BUSINESS DESCRIPTION AND OUTLOOK

Given the complexity of the Energy Wholesale and Retail business and in the interests of transparency, analysis of the key business functions has been provided below.

Energy Wholesale

On 16 October 2018, Energy Wholesale agreed to sell Generation to Drax Smart Generation HoldCo Limited ("Drax") which includes the sale of four CCGT power stations as well as pumped storage and hydro assets. The sale completed on 31 December 2018 for a consideration of £689 million. Generation owned and operated 2,531 MW of generating capacity comprising gas and hydroelectric generation assets. The results for the Generation group have been reported within Discontinued operations within the financial statements (refer to Note 28).

On 15 November 2018, the General Court of the Court of Justice of the European Union ("ECJ") found in favour of Tempus Energy, against the European Commission, annulling the Commission's decision not to raise objections to the state aid scheme establishing a Capacity Market in the UK. This judgement suspends the state aid approval for, and therefore the legality of, granting aid through the Capacity Market. As a result, the Capacity Market entered a 'standstill period' which prevents the UK Government from concluding any capacity auctions during the 'standstill period' (i.e. with full commitments to new capacity payments); making any capacity payments under existing agreements; or undertaking any other action which could be seen as granting state aid, until the scheme is approved again. This relates to Capacity Year 2018/19 (October 2018 to September 2019).

Before the European Union ("EU") Commission can provide state aid approval it must undertake a formal investigation. Energy Wholesale supports the UK Government's commitments to working closely with the EU Commission to secure state aid re-approval as soon as possible, so as to reinstate the Capacity Market, including making deferred payments to capacity providers. On 25 January 2019, the Commission launched an appeal against the ECJ judgement. Under the terms of the amendment agreement with Drax, legal specification was made to take account of the results of the formal investigation (refer to Contingent Asset and Contingent Liabilities Note 30).

Energy Wholesale will focus in future on managing the group's exposure to the UK wholesale electricity and gas markets for Retail and Renewables generation.

Energy Wholesale is now predominantly responsible for:

- the purchase of external supplies of electricity and gas for onward sale to customers;
- the optimisation of gas storage; and
- the sale of electricity from wind PPAs to wholesale market participants in the UK.

Energy Retail

Energy Retail is responsible for the supply of electricity and gas to domestic and business customers throughout the UK, including customer registration, billing and handling enquiries in respect of these services. Energy Retail is also responsible for the associated metering activity including the smart meter installation programme, and managing the group's Energy Services activities. During 2018, an average of 4.9 million gas and electricity customers were supplied by Energy Retail. As at 31 December 2018, Energy Retail supplied 5.0 million gas and electricity customers.

Competition in the UK market continues to increase with small and medium suppliers gaining a 26.7% domestic market share compared to 20.6% in 2017. Domestic market switching also reached record levels in 2018 according to the industry body, Energy UK, showing a year on year increase of 6% versus 2017. However, 2018 also saw an increased number of small and medium suppliers failing, with the group being appointed Supplier of Last Resort for Extra Energy's more than 222,000 customers in November 2018. Energy Retail leads the way in terms of the major suppliers, having the lowest percentage of domestic customers on standard variable tariffs ("SVTs") with under half of non-prepayment customers now on SVTs.

The Domestic Gas and Electricity (Tariff Cap) Act received Royal Assent on 19 July 2018, requiring Ofgem to place a cap on rates charged for the supply of gas and electricity to domestic customers on default tariffs until the end of 2020, extendable on an annual basis until 2023. Ofgem published its final decision on the level of the cap on 6 November 2018. The new cap came into effect on 1 January 2019 and will be updated on 1 April and 1 October each year. In the first cap period (1 January to 31 March 2019), the cap has been set at £1,137 for dual fuel customers with typical consumption paying by Direct Debit ("DD"), and £1,222 for those paying by standard credit ("SC"). On 7 February 2019, Ofgem announced an update to the cap level, effective from 1 April 2019, to £1,254 for those paying by DD and £1,344 for those paying by SC. The price cap is likely to have a negative impact on Energy Retail's income in 2019 although it will have less impact on Energy Retail than on other major suppliers with a greater proportion of SVT customers.

Energy Retail is working hard to continually make improvements to its customer service. In recent years Energy Retail has focused its efforts on improving customer service processes including call centre operations and online services. Where Energy Retail have further enhanced the online experience for both existing and prospective customers is to give them greater freedom as to how they set up a new account or manage an existing account. These digital tools provide an additional channel through which customers can more effectively manage their energy account, at a time that suits them.

Energy Retail offers specific help to its most vulnerable customers:

- The ScottishPower Hardship Fund, which was launched in May 2015, has provided over £32.5 million in debt relief to customers with financial difficulties.
- Energy Retail has also helped to refer around 10,000 customers in 2018 to get help with ongoing household budget and debt issues from its free debt advice charity partner, National Debtline.
- Following changes to the supply licence, Energy Retail has made available to customer-facing staff new options for categorising customer vulnerability, such as for customers in temporary vulnerable situations. These will help Energy Retail to better support customers during periods of uncertainty.
- The ScottishPower Energy People Trust Fund ("the Trust") (an independent registered charity (SC036980)) funds other registered charities that help people whose lives are affected by fuel poverty. During 2018, the Trust awarded over £0.6 million to 17 projects, helping over 7,000 households (over 16,000 individuals). In light of ScottishPower's decision to consolidate its future charitable funding through the ScottishPower Foundation (a separate charity established in 2013), the Trustees resolved during 2017 to wind up the Trust upon the completion of all beneficiary projects, and the exhaustion of the Trust's funds. Dissolution of the Trust is expected to complete during 2019.

STRATEGIC REPORT *continued*

ENERGY WHOLESALE AND RETAIL *continued*

BUSINESS DESCRIPTION AND OUTLOOK *continued*

Energy Retail *continued*

The delivery of energy efficiency measures continues to be an important responsibility of Energy Retail and 2018 was the fifth year of delivery of the UK Government's Energy Company Obligation ("ECO"). The ECO scheme focuses on reducing heating costs for the most vulnerable customers, and also aims to improve the energy efficiency of properties. Energy Retail continues to make strong progress towards meeting this obligation and has delivered a sufficient volume of measures to meet its "ECO 2" scheme obligation targets. Legislation which defines the "ECO 3" scheme came into effect in December 2018 and covers the period from that date until 31 March 2022. Changes to the scheme now require the participation of some smaller suppliers who have previously been exempt. Energy Retail also supports vulnerable customers with their energy bills through the Warm Home Discount scheme ("WHD"), spending £32 million in 2018 and providing assistance to over 207,000 customers.

Energy Retail continues to play its part in the roll out of smart meters and has made good progress in 2018 in mobilising and increasing its smart deployment capabilities, focusing on achieving the regulatory target of taking all reasonable steps to install a smart meter at all premises by the end of 2020. In excess of one million smart meters have been installed to date. Energy Retail has established a UK-wide network of installers, who provide a strong platform to further increase its deployment capability for the remainder of the roll out.

Energy Retail is expanding its Smart Energy Services offerings including new boiler care services, appliance cover and smart thermostat control. In November 2018, Energy Retail announced that it would be focusing on prioritising the UK's switch to cleaner greener transport by unveiling the UK's first end-to-end package for EV ownership. It has agreed a unique link-up with the major car retailer, Arnold Clark, allowing buyers to purchase or lease an EV of their choice, book a home charging point installation and sign up to an exclusive 100% renewable energy tariff as part of the same package. Customers will receive the UK's smallest fast charging point as well as having access to the ScottishPower App to facilitate smart charging. Customers can elect to receive both their gas and electricity supply from ScottishPower under the tariff component of the EV package. The electricity supplied under this tariff is backed by Renewable Energy Guarantee of Origin ("REGO") certificates.

The impact of Brexit on Energy Wholesale and Retail is considered on pages 9 and 10 of the Strategic Report.

2018 OPERATIONAL PERFORMANCE

Financial key performance indicators ("KPIs")	Revenue *		Operating profit/(loss) **		Capital investment ***	
	2018 £m	2017 £m	2018 £m	2017 £m	2018 £m	2017 £m
Continuing operations – Energy Wholesale and Retail	3,919.9	3,879.7	124.8	(62.5)	165.4	184.3

* Segment total revenue as presented in Note 4 on page 52.

** Segment operating profit as presented in Note 4 on page 53.

*** Segment capital investment as presented in Note 4 on page 55.

Energy Wholesale and Retail revenue increased by £40 million to £3,920 million in 2018. Energy Retail revenues increased by £117 million primarily driven by higher Retail prices partly offset by the impact of lower average customer numbers. Wholesale revenues decreased in 2018 by £77 million.

Operating profit increased by £187 million to £125 million in 2018. This reflected increased gross margins (higher Retail prices offsetting the adverse impacts of lower domestic demand and increases in energy and government obligation costs). Operating costs reductions included £23 million due to the profile of costs incurred to deliver ECO obligations as well as a £10 million positive movement in reorganisation costs year on year. Depreciation reduced year on year, reflecting the impact of the increase in the useful life of the customer relationship management system, partially offset by increased depreciation in respect of smart meter investments.

Capital investment in Energy Wholesale and Retail decreased by £19 million reflecting a reduction in the investment to prepare IT systems for the roll out of smart metering.

Non-financial key performance indicators

	Notes	2018	2017
Volume supplied (GWh)		47,781	51,105
Customer service performance	(a)	4th	5th
Customers (thousands)	(b)		
- Electricity		2,951	3,170
- Gas		1,956	2,115
		4,907	5,285

(a) Based on the Citizens Advice Domestic Energy Suppliers' Customer Service Report. Rankings reflect the group's position relative to the other 'Big Six' Energy Companies.

(b) Customer numbers are based on the average number of Meter Point Administration Numbers for electricity customers and Meter Point Reference Numbers for gas customers during the year to 31 December.

LIQUIDITY AND CASH MANAGEMENT**Cash and net debt**

The group operates and manages a centralised cash management model within the UK with liquidity being centralised at the Scottish Power Limited level. The group's liquidity position and short-term financing activities are integrated and aligned with Iberdrola's.

The Iberdrola group objective is to retain sufficient liquid resources and facilities to cover anticipated cash flow requirements for a period in excess of twelve months; current liquidity in the Iberdrola group is in excess of €13 billion, which can be utilised if required to fund group activities.

Net cash flows from operating activities increased by £38.2 million to £995.0 million for the year. As detailed in the table below, net debt decreased by £100.5 million to £4,956.0 million. Group loans payable increased by £456.1 million while group loans receivable decreased by £113.8 million. Cash and short-term deposits increased by £693.9 million to £739.5 million. External loans payable increased by £23.5 million to £1,836.0 million.

Analysis of net debt	Notes	2018 £m	2017 £m
Cash and short-term deposits	(a)	739.5	45.6
Group loans receivable	(b)	451.9	565.7
Group loans payable	(c)	(4,311.4)	(3,855.3)
External loans payable	(d)	(1,836.0)	(1,812.5)
Net debt		(4,956.0)	(5,056.5)

(a) As detailed on the consolidated balance sheet on page 30.

(b) As detailed in Note 10 on page 75.

(c) Loans with Iberdrola and other related Iberdrola group companies as detailed in Note 18 on page 83.

(d) External loans payable comprises external debt as detailed in Note 18 on page 83.

Capital and debt structure

The company is funded by a combination of debt and equity; all equity being held by Scottish Power Limited. The group's financing structure is determined by its position in the wider Iberdrola group. As stated above, the group can obtain funding via the liquidity resources maintained at the Iberdrola group. The company holds investment grade ratings with Moody's Investor Services (Baa1), Standard & Poor's Rating Services (BBB+) and Fitch Ratings (BBB+). Details of the group's financial risk management policy are set out at Note 9(e).

TAXES AND OTHER GOVERNMENT OBLIGATIONS

To help give an understanding of the group's contribution to UK taxes and other UK Government obligations, the following table has been provided, highlighting the key taxes and other obligations in the financial year, on an accruals and cash basis.

Analysis of taxes and other government obligations for continuing and discontinuing operations	Note	Income statement expense		Cash tax paid in the year	
		2018 £m	2017 £m	2018 £m	2017 £m
Carbon tax		38.9	52.2	46.3	55.6
Social security costs		31.4	30.1	30.2	30.7
Taxes other than income taxes		197.6	223.3	193.3	234.5
UK Corporation Tax	(a)	105.0	48.2	40.7	37.5
		372.9	353.8	310.5	358.3

(a) UK Corporation Tax as presented in Note 27 on page 89.

HEALTH AND SAFETY

The prevention of harm to employees, contractors and members of the public, and the protection of business assets and operational capability, are top priority for the group. The group has continued to strive for improved performance and both internal and external assessments have again returned positive findings. The main business areas within the group maintained OHSAS 18001 Health and Safety Management System certification. The annual group employee accident and incident statistics remained low with six lost time accidents in 2018. This equates to approximately one lost time accident per 1,000 employees. Three of these lost time accidents* were reported to the Health and Safety Executive ("HSE") under The Reporting of Injuries, Diseases and Dangerous Occurrences Regulations ("RIDDOR"). The commitment to investigate accidents and incidents to address the root causes remains steadfast and is given the highest priority with panels of inquiry being established whenever there is a significant incident. The table below provides the occurrence of lost time accidents in each business.

Lost time accidents*	2018	2017
Energy Networks	4	2
Renewables	–	–
Energy Wholesale and Retail	2	1
Corporate	–	–
	6	3

* Number of accidents involving Scottish Power UK plc employees on the job resulting in the loss of at least a day's work.

Provision of public safety information and school education regarding safety around electricity has continued through a mixture of attendance at community events, safety centres and school teaching programmes. The group provides electrical safety information to groups who are at a high risk of coming into contact with apparatus on the electricity network, including agricultural and construction workers as well as delivering safety education in schools.

UK DECISION TO LEAVE THE EU (BREXIT)

The UK was originally scheduled to leave the EU on 29 March 2019. Following intensive negotiations on the subjects of a separation payment, mutual recognition of citizens' rights and avoiding a hard border between Northern Ireland and the Republic of Ireland, two key documents were approved by the EU Council on 25 November 2018: the EU Withdrawal Agreement (a legally binding document setting out the terms of the UK's exit from the EU, including citizens' rights and the Irish 'backstop'); and the Political Declaration (setting out the basis for a future negotiation of the future UK-EU relationship after Brexit, including UK-EU trade and security). As at the date of signing these accounts this deal has not been approved by the UK Parliament; cross party discussions are taking place to reach a consensus on a revised deal to be presented to the UK Parliament for approval. The EU and the UK have now agreed a delay to Brexit until 31 October 2019 at the latest, assuming that the UK takes part in the European Parliamentary elections on 23 May 2019. If the UK does not participate in the European elections then the UK will need to leave the EU on 1 June 2019 under a 'no-deal' scenario unless the UK Parliament has approved an EU Withdrawal Agreement.

If the EU Withdrawal Agreement is not approved by the UK Parliament within the EU timelines the risk of a 'no-deal' Brexit exists. This would probably mean that the trade relationship between the UK and EU would revert to World Trade Organisation ("WTO") rules. The UK Government has published a series of technical papers covering some of the key areas of concern in the event of 'no-deal' scenario. Essentially these papers seek to minimise the impacts as much as possible, including by limiting the scale of the changes to existing arrangements. Nevertheless, WTO rules would mean that trade between the UK and EU which is currently frictionless, would become cross-border trade subject to customs checks and tariffs. In the event of a 'no-deal' scenario some economic disruption is expected in the UK and thus ScottishPower is preparing to mitigate any negative impacts arising from this outcome. A cross-party operational working group has been co-ordinating ScottishPower's preparations to mitigate the impact of a 'no-deal' Brexit. Some of the key risks considered are explained in the table below.

SCOTTISHPOWER – BREXIT RISKS

RISK	RESPONSE
Impacts arising from the UK decision to leave the EU or market reactions to events during the negotiation. These impacts could include movements in the value of Sterling and other financial instruments. In the longer term there could be positive or negative changes in the UK economy and in the political and regulatory environment in which the group operates.	In addition to monitoring ongoing developments related to Brexit the treasury risk management policy is in place to hedge financial risks which are the most prevalent in the short term. Any longer term impact on the UK economy and its impact on the group and specific business units will be managed in line with developments. A ScottishPower wide regulatory group is monitoring any potential risks arising from a regulatory perspective and is engaging with governments and regulators to minimise any disruption.
Supply chain disruption – import delays of key equipment and components for major programmes causing project delays. Applicable across the ScottishPower group.	Assessment of key equipment and components undertaken and additional orders placed in order to increase stock levels. Additional storage requirements also assessed and actions taken to ensure there is sufficient storage.
Foreign exchange rate exposure and additional tariffs if WTO rules apply. Applicable across the ScottishPower group.	Exchange rate hedged on existing orders and contracts. Legal review of all critical contracts to determine potential exposure to additional tariffs.
Contractual risk for existing non-trading contracts including the risk of contract re-openers, clauses such as force majeure/material adverse change clauses and jurisdiction. Applicable across the ScottishPower group.	Legal review of all critical contracts to determine potential exposure and mitigation specific to each contract.
Contractual risk for existing trading contracts (Energy Wholesale and Retail) including master trading agreements and broker and exchange contracts.	Risk based assessment of all contracts although some are UK only contracts and are therefore unaffected and the majority of brokers and exchanges are UK-based.
Free movement of labour – potential restrictions on EU nationals working in the UK or international assignees from elsewhere in the Iberdrola group, not currently in the UK but wishing to enter the UK. Applicable across the ScottishPower group.	Recent announcements by the UK Government confirmed EU nationals in the UK will be part of an EU settlement scheme. Workplace audit underway to assess impact and support staff affected through the process. Contingency arrangements being set up for offshore workers.
Data Protection – impact of General Data Protection Regulation ("GDPR") rules and status of UK post Brexit could impact transfer of data between group companies and suppliers in the normal course of business. Applicable across the ScottishPower group.	All intercompany contracts reviewed to update contractual clauses. High risk suppliers identified and where appropriate discussions commenced to amend contractual terms.

STRATEGIC REPORT *continued*

UK DECISION TO LEAVE THE EU (BREXIT) *continued*

Even in the event of an agreement being concluded, Brexit may have both risks and opportunities for ScottishPower. Until the terms of exit and the nature of the future relationship are clear, it is not possible to be definitive about these.

Many of the risks described above relating to a 'no-deal' scenario arise from so-called 'horizontal' issues where there could be issues affecting businesses in many sectors of the economy. UK official forecasts are for a negative impact on the UK economy as a whole; in the event of a 'no-deal' scenario it might be sharply negative, at least for the short/medium term. Variation in market views on this last factor is likely to manifest itself in movements (up or down) in the value of Sterling and inflation, which is likely to have impacts on most ScottishPower businesses, except to the extent that these can be hedged.

ScottishPower will continue to monitor the impact of Brexit and take appropriate action to protect the operations of each of the businesses as the outcome of the Brexit deal becomes clearer.

PRINCIPAL RISKS AND UNCERTAINTIES

ScottishPower's strategy, and so that of the group, is to conduct business in a manner benefiting customers through balancing cost and risk while delivering shareholder value and protecting ScottishPower's performance and reputation by prudently managing the risks inherent in the business. To maintain this strategic direction ScottishPower develops and implements risk management policies and procedures, and promotes a robust control environment at all levels of the organisation.

During 2018, the governance structure was supported by risk policies approved by the Board of Directors of Iberdrola and adopted by the Board of Directors of Scottish Power Limited ("the Board"). ScottishPower's business risk assessment team and independent group Risk Management function supported the Board in the execution of due diligence and risk management. In addition, ScottishPower is represented at the Iberdrola Risk Management Committee to ensure that the business risks are adequately assessed, monitored, mitigated and managed. Further details of ScottishPower's governance structure and risk management are provided in Note 9(e) to the Accounts.

The principal risks and uncertainties of ScottishPower, and so that of the group, other than those specific to Brexit already discussed, that may impact current and future operational and financial performance and the management of these risks are described below:

SCOTTISHPOWER – GLOBAL

RISK	RESPONSE
Material deterioration in the relatively stable and predictable UK regulatory and political environment, including any sudden changes of policy, or interventions outside established regulatory frameworks.	Positive and transparent engagement with all appropriate stakeholders to ensure that long-term regulatory stability and political consensus is maintained and public backing is secured for the necessary investment in the UK energy system. Providing stakeholders with evidence of the risks of ad hoc intervention in markets.
A major health and safety incident in the course of operations could impact staff, contractors, communities or the environment.	ScottishPower's Health and Safety function provides specialist services and support for the businesses in relation to health and safety. A comprehensive framework of health and safety policy and procedures, alongside audit programmes, is established throughout ScottishPower, which aim to ensure not only continuing legal compliance but also drive towards best practice in all levels of its health and safety operations.
Breach in cyber security and unwanted infiltration of the ScottishPower IT infrastructure by internal and external parties.	Implementation of a cyber-risk policy which provides the framework for mitigation. Proactive approach to identifying where ScottishPower is vulnerable and addressing these points through technical solutions. Educating company employees as to how behaviour can reduce this risk. Embedding cyber security in all projects where appropriate.

STRATEGIC REPORT *continued*

PRINCIPAL RISKS AND UNCERTAINTIES *continued*

ENERGY NETWORKS	
RISK	RESPONSE
Potential reduction in base regulatory revenues as a result of RIIO-2 price control process, which Ofgem has commenced.	Steering group and dedicated teams in place to produce robust business plan submission; extensive proactive engagement with Ofgem and other stakeholders.
Inability to recruit or retain an appropriately skilled workforce.	A Strategic Workforce Planning and Implementation plan that incorporates: a) retirement profiles with demographics; b) a one year ahead strategic recruitment plan; and c) a ten year strategic recruitment plan. Identification of business critical roles and succession planning.
Security of supply due to potential asset failures alongside reduced generation capacity.	Risk based asset investment programme in place, business continuity and emergency planning well established including Black Start. Strategic spares policy in place.
Failure to deliver the distribution and transmission outputs agreed with Ofgem in their respective price controls.	Mitigating actions include formulating detailed investment, resource, outage and contingency plans supported by an extensive procurement strategy. Good communication and co-ordination of activities across the business is integral to success, complemented by a comprehensive monitoring regime that provides early warning of potential issues.
Failure to protect customer service performance.	Well-established customer service processes to respond to power loss, including storm readiness. Priority Service Register to protect vulnerable customers in the event of power loss. Implementation of a single emergency number to route customer queries.
Failure to respond to customers' changing requirements and to deploy new technologies through low carbon transition, for example electric vehicles, distributed generation, storage and heat pumps.	Mitigating actions include owning a clear DSO vision and influencing developments at industry forums, undertaking scenario modelling of the impact of low carbon technologies, considering technical and commercial innovation projects and engaging with key stakeholders.

STRATEGIC REPORT *continued*

PRINCIPAL RISKS AND UNCERTAINTIES *continued*

RENEWABLES	
RISK	RESPONSE
Concerns about affordability of renewable generation having an impact on chances of success in a competitive auction process.	Actions to reduce allocation risk, including engagement with the UK Government regarding access and parameters of the CfD mechanism. Working to optimise Renewables' portfolio of assets and approach to development to ensure high performing and competitive assets will be able to participate in future auctions.
Limited route to market for new onshore wind.	Engagement with national and local government to influence and inform policy regarding onshore wind as the cheapest form of scalable new-build generation (including life extension and repowering) in the future generation mix to ensure optimal levels of deployment, particularly in Scotland. In addition, exploration of new routes to market such as private and corporate PPAs continues.
The potential for plant performance issues reducing availability.	Proactive technical assessments and monitoring of key risk areas associated with wind turbine performance, diversification of the service and maintenance model where reliance is placed on framework agreement for key activities, optimising service and maintenance activities to ensure each activity is appropriate based on operational knowledge. In addition, co-ordination with the procurement team in negotiating terms and conditions with turbine suppliers and independent operations and maintenance service providers to ensure plant performance is optimised.
Failure to deliver large and complex projects on time and within budget.	ScottishPower and Iberdrola have a strong track record in delivering large scale engineering projects and have gained significant experience from developing the WODS and Wiking offshore wind farms. Risks are further reduced by using established and experienced suppliers and advisors along with robust financial management including appropriate foreign exchange hedging.

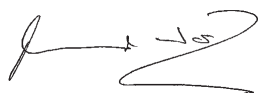
STRATEGIC REPORT *continued*

PRINCIPAL RISKS AND UNCERTAINTIES *continued*

ENERGY WHOLESALE AND RETAIL

RISK	RESPONSE
Default price cap on dual fuel tariff not set at cost reflective rate to allow a reasonable profit margin.	Continued focus on encouraging competition and promoting the use of fixed-price products; ongoing dialogue and lobbying of government and regulatory bodies to mitigate the risk. Lower proportion of customers on default tariffs reduces the impact in comparison to other major suppliers.
Inability to efficiently hedge the exposure to power prices due to the complexity of the price cap pricing mechanism.	Continuous assessment of the wholesale energy markets and constant monitoring of the impact of market movements across seasons.
The potential for non-compliance with the UK Government's mandate to complete the roll out of smart metering to customers in accordance with prescribed timescales.	Dedicated project team focused on ensuring adequate business processes and systems are developed. The team is responsible for ensuring the roll out capability is secured to enable deployment of meters. Energy Retail is an active participant in industry bodies responsible for developing smart metering technology and capability across the UK.
Reputational risk from poor customer service performance.	Continued investment in additional resource and employee training to handle customer queries and respond to complaints. Further mitigating actions include continued enhancement to key processes, including investment in the Energy Retail customer website.

BY ORDER OF THE BOARD



David Wark
Director
29 April 2019

DIRECTORS' REPORT

The directors present their report and audited Accounts for the year ended 31 December 2018. References to 'ScottishPower' below apply fully to 'the group'.

INFORMATION CONTAINED WITHIN THE STRATEGIC REPORT

The directors have chosen to disclose information on the following, required by the Companies Act 2006 to be included in the Directors' Report, within the Strategic Report, found on pages 1 to 13:

- information on financial risk management and policies; and
- information regarding future developments of the business.

RESULTS AND DIVIDEND

The net profit for the year attributable to the equity holders of the parent amounted to £818.3 million (2017 £425.9 million – as restated). A dividend of £563.2 million was paid during the year (2017 £300.0 million).

TAXATION

The Board of Directors of Iberdrola has explicitly acknowledged its responsibility for tax policy and strategy in all of the companies that it controls. The Iberdrola Board has approved a Corporate Tax Policy which forms part of the Corporate Governance System and sets out that Board's commitment to responsible tax practices throughout the Iberdrola group. The Corporate Tax Policy was initially approved by the Iberdrola Board in 2010 and is regularly updated.

The Board of Directors of Scottish Power Limited has adopted this Corporate Tax Policy and its Audit and Compliance Committee has approved the ScottishPower Tax Strategy which accords with the Policy and, as required by UK law, is published on the company's website. This can be found at: www.scottishpower.com/pages/tax_strategy.aspx.

ScottishPower is a responsible tax payer and seeks to be open, honest and transparent in dealings with the tax authorities and to comply with both the letter and the spirit of tax laws set by the UK Government. ScottishPower remits taxes due on a timely basis, and has a relationship with HM Revenue & Customs ("HMRC") based on mutual trust and cooperation. Payment of taxes is ScottishPower's principal contribution to sustaining public expenditure and one of its contributions to society.

Further details on taxes and other government obligations can be found in the Strategic Report on page 8.

INNOVATION

ScottishPower believes that innovation plays a fundamental role in the success of the business. Innovation efforts span across internal culture, systems and academic and supply chain partnerships with the aim of identifying future value. All innovation areas are developed as part of Iberdrola's global open and decentralised innovation model.

ScottishPower's main innovation themes during the past year have delivered projects such as improving operational efficiencies using data analytics, increasing productivity through asset optimisation and delivering improved customer experience through digitisation. Detailed information in relation to ScottishPower's wider innovation activities can be found in the Iberdrola Innovation Report. The most recent report can be accessed via the 'Sustainability' section of www.iberdrola.com.

ENVIRONMENTAL MANAGEMENT AND REGULATION

Throughout its operations, the group strives to meet, or exceed, relevant legislative and regulatory environmental requirements and codes of practice. The group has developed an Integrated Environmental Management System that covers its operating business activities; (transmission and distribution of electricity; asset management; renewable generation; corporate areas; and until 31 December 2018, CCGT and hydro). In 2018, the System was successfully certified in line with the ISO14001:2015 international standard. Within the environmental management framework, The group has promoted reduced carbon emissions across the organisation, including supporting a transition to EVs in both fleet cars as well as personal vehicles. The environmental activities of the group are governed within the Iberdrola Global Environmental Management Model.

Detailed information on the group's approach to environmental management and performance can be found in the Iberdrola Sustainability Report. The most recent report can be accessed via the 'Sustainability' section of www.iberdrola.com.

Further information on applicable environmental regulations is available on request from the Company Secretary.

EMPLOYEES

The group had 5,611 employees at 31 December 2018 (2017 5,761 – as restated). Of these, 3,009 (2017 3,014) were employed in Energy Networks, 395 (2017 367) in Renewables, 1,696 (2017 1,849 – as restated) in Energy Wholesale and Retail, with the remaining 511 (2017 531) employed in Corporate services.

Employment regulation

The group has well-defined policies in place throughout its businesses to ensure compliance with applicable laws and related codes of practice. These policies cover a wide range of employment issues such as disciplinary, grievance, harassment, discrimination, stress, anti-bribery and 'whistleblowing' and have been brought together in the Code of Ethics of Iberdrola and its group of companies (which also outlines expectations for employees' conduct).

Training

The group has a continuing commitment to training and personal development for its employees with 3,061 (2017 2,900) training events in the year. Much of the training is focused on health and safety and technical training ensuring field staff are safe and competent. In addition the group recruits over 100 craft and engineering trainees annually who undertake a formal, structured training programme leading towards a recognised apprenticeship or formal engineering qualification. Team leaders and managers also participate in core management skills training and there are management development programmes and modules aimed at increasing leadership capability.

DIRECTORS' REPORT *continued*

EMPLOYEES *continued*

Employee feedback and consultation

In 2018, the group carried out its annual employee engagement survey, 'The LOOP' as part of an Iberdrola group engagement survey framework. The survey provides key insight on what employees feel about working for ScottishPower. The response rate in 2018 equalled 2017, with 75% of employees providing feedback. The results of the survey highlighted a number of strengths and opportunities and overall 61% of employees feel proud to work for ScottishPower. Areas of strength highlighted were in relation to collaboration, performance management and safety. The opportunities identified as part of the feedback where the ScottishPower businesses have the opportunity to respond to challenges are around providing more clarity on ScottishPower's future strategy, enabling employees to carry out their role and supporting employees to develop and grow through the organisation. These areas are a focus for the ScottishPower action plan going forward.

In addition to employee feedback, ScottishPower regularly consults with employees and their representatives via a variety of channels, including monthly team meetings, business conferences, health and safety committees and employee relations forums.

Inclusion and diversity

Inclusion and diversity fosters innovation and creativity, driving better business performance. ScottishPower is working hard to create an inclusive and diverse workplace that is open to change; where employees feel they can be themselves.

In March 2018, ScottishPower welcomed the steps the UK Government has taken to introduce legislation on gender pay gap reporting.

ScottishPower is committed to pay for performance equally and fairly, and is focused on breaking down barriers across the employee lifecycle as over time this will improve the Gender Pay Gap position whilst widening the inclusion of other under-represented groups. Key activities during 2018 included the design and roll out of e-learning and training on diversity and unconscious bias for recruiting managers and newly appointed managers. In addition, in 2018 ScottishPower welcomed six females into Science, Technology, Engineering and Mathematics ("STEM") based placements as part of the Women Returners programme to support women returning to work after a lengthy career break. The programme aims to help women grow their career after a career break from the STEM sector, offering the time and support needed to refresh and redevelop their skills to help them in returning to employment on a more permanent basis.

As part of its commitment to closing the gender pay gap the ScottishPower Senior Leadership Team have set two aspirational targets to break down the barriers for women:

- Increase the number of women in ScottishPower's senior leadership population to exceed 30% (currently 21%).
- Increase the number of women in ScottishPower's middle management population to exceed 40% (currently 29%).

For more information on ScottishPower's gender pay gap please go to https://www.scottishpower.com/pages/gender_pay.aspx

ScottishPower continues to forge links with a number of recognised organisations to grow its commitment to diversity and inclusion. These include: Business Disability Forum, Employers Network for Equality & Inclusion, Equate, Working Families, ENABLE, POWERful Women and Stonewall.

ScottishPower expects all employees to be treated with respect and has supporting policy guidance on People with Disabilities to help ensure equality of employment opportunity for people with disabilities. ScottishPower have obtained the Disability Confident standard and are accredited to an 'engaged level' with Carers Scotland. In addition, in 2018 ScottishPower was part of an inspirational programme, called Breaking Barriers. The programme aimed to raise aspirations for young people who have learning disabilities and provide equal opportunities to access university. Between January and June 2018 eight learners aged 18 to 24 studied for a Certificate in Applied Business Skills at the University Of Strathclyde Business School. As part of this experience the learners gained valuable skills and work experience as part of an eight week placement with ScottishPower.

Employee health and wellbeing

ScottishPower promotes and supports the physical and mental health and wellbeing of its employees through a programme of health promotion and information run by its occupational health department.

Employee volunteering

ScottishPower prides itself in being a good corporate neighbour, providing support to the communities it serves in each of its businesses. Volunteering is central to community involvement and ScottishPower has an excellent track record in this area. ScottishPower's company-wide Volunteering Policy has been actively utilised by employees during 2018. This policy gives all registered volunteers, on an annual basis, an opportunity to take an additional one day's paid leave, to be used as a volunteering day.

Modern slavery statement

ScottishPower is committed to human and labour rights and to eliminating modern slavery that could in any way be connected to its business.

ScottishPower welcomed the introduction of the Modern Slavery Act 2015. ScottishPower published its most recent Modern Slavery Statement in May 2018 which was approved by the Board of Directors of Scottish Power Limited and signed by Keith Anderson, Chief Executive Officer.

ScottishPower's Modern Slavery Statement is published on the ScottishPower's website at; www.scottishpower.com/pages/scottishpowers_modern_slavery_statement.aspx.

COMMUNITY RELATIONSHIPS

Building the trust of communities has been part of ScottishPower's core values for many years. ScottishPower has a significant presence in many communities and aims to conduct its activities responsibly, in a way that is considerate to local communities and makes a positive contribution to society.

Community consultation

ScottishPower engages with communities across its operations where both new and modernising developments are planned, or where ScottishPower is decommissioning redundant or non-operational assets. The key areas where ScottishPower's business interacts with the community include the siting of new facilities such as wind farms, the presence of distribution and transmission lines, decommissioning older plant and routine maintenance and upkeep work. ScottishPower takes a proactive approach to providing good and accurate information from pre-planning through to construction.

DIRECTORS' REPORT *continued*

COMMUNITY RELATIONSHIPS *continued*

Community consultation continued

ScottishPower maintains strong relationships with local communities by working with community groups, elected representatives, interest groups and individuals to ensure that those who may be affected by the work are aware of what is happening in their area in advance, and thus allowing communities to have their say. This is of particular importance to the business as a developer, owner and operator with longstanding relationships in many of the communities in which it works.

A variety of methods of consultation are used to keep in touch with the needs and concerns of the communities potentially affected. ScottishPower's community consultation processes include representation at community meetings, presentations and forums such as Public Information Days and the publication of information on the ScottishPower website and social media outlets. ScottishPower's facilities host visits from community groups, maintain a number of visitor centres and run Local Liaison Committees which provide a forum for discussion between local management teams and community representatives.

As many of ScottishPower's assets, such as wind farms and pylons, are situated on land not owned by ScottishPower, it is important that effective policies are in place to ensure that the safety and integrity of the plant is maintained, while respecting the needs of the landowner, the local community and the general public. Energy Networks and those working on its behalf adhere to a Grantor's Charter which sets out guidance of commitment to grantors and has been prepared in consultation with key stakeholders.

Energy Networks has shaped its business around geographical districts, enabling them to get closer to the communities they serve and allowing local communities to have unprecedented influence upon the delivery of network projects in their area. A wide range of local partnerships have been developed to gain a better understanding of community needs, including vulnerability and to increase resilience in the communities served, whilst maintaining focus on excellent customer service. Strong engagement is placed at the heart of decision making at all levels of the organisation, winning the trust of communities and stakeholders.

Investing in the community

ScottishPower has a long track record of supporting communities not only financially, but also by sharing its resources and the skills of its employees. ScottishPower promotes payroll giving and encourages employee development through volunteering and community-based programmes. Opportunities are created for local employment during construction and operations through events such as "Meet the Developer" days where local contractors are invited to find out about opportunities at the group's facilities. The group works closely with the UK and devolved administrations to develop policy on community engagement and benefit and to ensure that ScottishPower adheres to all voluntary codes of good practice.

As part of the Iberdrola group, ScottishPower uses the London Benchmarking Group ("LBG") framework to evaluate its community investment activity. The framework is used by hundreds of leading businesses around the world and provides a comprehensive and consistent set of measures for companies to determine their contributions to the community.

During the year ended 31 December 2018, ScottishPower voluntarily contributed £12.8 million (2017 £12.3 million) in community support activity through cash, time, in kind support and management costs associated with running community programmes. The £12.8 million (2017 £12.3 million) total incorporated £0.5 million (2017 £0.5 million) in management costs, £6.9 million (2017 £6.6 million) categorised as community investment, £5.4 million (2017 £5.2 million) categorised as commercial initiatives and less than £0.1 million categorised as charitable gifts in both 2018 and 2017; all given in cash, through staff time and 'in-kind' donations. Included within these figures, Renewables made £5.2 million (2017 £3.6 million) in voluntary community benefit payments to the communities neighbouring its wind farms.

These figures are compiled for the Iberdrola Sustainability Report and will be independently verified in early 2018 by Managing a Sustainable Business, S.L. which administers LBG in Spain.

ScottishPower Foundation

ScottishPower established the Scottish Power Foundation to reinforce ScottishPower's commitment to charitable work throughout the UK. The Scottish Power Foundation is a registered Scottish charity (SC043862) and a company limited by guarantee (SC445116). Registered Office: 320 St. Vincent Street, Glasgow, Scotland G2 5AD. It provides funds to support charitable initiatives that promote the advancement of education, environmental protection, citizenship and community development, arts, culture and science as well as the prevention of poverty or disadvantage.

POLITICAL DONATIONS AND EXPENDITURE

ScottishPower is a politically neutral organisation. It is subject to the Political Parties, Elections and Referendums Act 2000, which defines political "donations" and "expenditure" in wider terms than would be commonly understood by these phrases. During the year ended 31 December 2018, ScottishPower paid a total of £24,500 (2017 £23,020) for the sponsorship of conferences and events – activities that may be regarded as falling within the terms of the Act.

The recipients of these payments were:

- | | |
|-------------------------------|-----------------------|
| • The Conservative Party | £7,000 (2017 £7,000) |
| • The Labour Party | £7,000 (2017 £7,000) |
| • The Scottish National Party | £10,500 (2017 £9,020) |

These amounts were for sponsored receptions at the 2018 conferences of the above parties. These occasions provide an important opportunity for ScottishPower to represent its views on a non-partisan basis to politicians from across the political spectrum and were open to everyone attending the conference, including party members, non-governmental organisations, the media and trade unions. The payments do not indicate support for any particular party.

DIRECTORS' REPORT *continued*

CORPORATE GOVERNANCE

The ultimate parent of the company is Iberdrola, S.A., which is listed on the Madrid stock exchange.

As a guiding principle, ScottishPower, and so the group, adopts the principles and rules contained in the most widely recognised good governance recommendations and, in particular, has taken as a reference (for guidance purposes only) the Uniform Good Governance Code for Listed Companies approved by the National Securities Market Commission of Spain. The company is not, however, subject to any corporate governance codes and, in particular, is not subject to the Uniform Good Governance Code for Listed Companies.

Administrative, management and supervisory bodies

Board and management meetings

The company is governed by a Board, consisting of three directors (refer to page 21) who bring a broad range of skills and experience to the company. All are full-time employees of the Iberdrola group.

The directors of the company are subject to annual evaluation of their performance in respect of their executive responsibilities as part of the performance management system which is in place throughout ScottishPower.

The Management Committee is a permanent internal body, without executive function, which was established by the Scottish Power Limited Board ("ScottishPower Board") to provide a coordinating role for activities of ScottishPower. The Management Committee meets weekly and receives regular information on the activities of ScottishPower in order to support the corporate functions and lines of business in understanding the local, legal, regulatory and market specifics in the UK and assists the Chief Executive Officer ("CEO") in the performance of his duties. The Management Committee comprises the following executives: the CEO (who was also the CEO of the Renewables business until February 2018 when he became CEO of ScottishPower, which replaced the previous Chief Corporate Officer ("CCO") role); the directors of Control and Administration, Regulation, Human Resources, UK Purchasing and Communications; the CEO of the Regulated Business (Energy Networks); the CEO of the Renewables business; the CEO of the Liberalised Business (Energy Wholesale and Retail); and the Head of Legal and General Secretary.

The Boards of Scottish Power Energy Networks Holdings Limited ("SPENH"), Scottish Power Retail Holdings Limited (formally known as ScottishPower Generation Holdings Limited) ("SPRH") and ScottishPower Renewable Energy Limited ("SPREL") are responsible for the effective management of the Regulated, Liberalised and Renewables businesses respectively, in accordance with the strategy set by the ScottishPower Board. These Boards meet regularly and review strategy, operational performance and risk issues on behalf of the respective business.

SPENH Board

The SPENH Board comprised the Chairman Armando Martínez Martínez and six other directors as at 31 December 2018. The directors and their attendance at SPENH Board meetings held during the period under review (five meetings) are shown below:

Armando Martínez Martínez (Chairman)	Attended all meetings
Frank Mitchell (Chief Executive Officer)	Attended all meetings
Antonio Espinosa de los Monteros	Attended all meetings
José Izaguirre Nazar	Attended four meetings
Scott Mathieson	Attended all meetings
Wendy Barnes (Independent non-executive director)	Attended all meetings
Alison McGregor (Independent non-executive director)	Attended one meeting (appointed 15 November 2018)
Suzanne Fox (Independent non-executive director)	Attended all meetings (resigned 15 November 2018)

The terms of reference of the SPENH Board are published at:
www.scottishpower.com/userfiles/file/SPENHL-Terms%20of-Reference-Board-Directors-130603.pdf.

SPREL Board

The SPREL Board comprised the Chairman Xabier Viteri Solaun and five other directors as at 31 December 2018. The directors and their attendance at SPREL board meetings held during the period under review (five meetings) are shown below:

Xabier Viteri Solaun (Chairman)	Attended all meetings
Keith Anderson (Chief Executive Officer)	Attended one meeting (resigned 2 May 2018)
Lindsay McQuade	Attended two meetings (appointed 17 July 2018)
Jonathan Cole	Attended four meetings
Javier García de Fuentes Churrua	Attended all meetings
Rafael de Icaza de la Sota	Attended all meetings
Lena Wilson (Independent non-executive director)	Attended all meetings

During February 2018, following an internal organisational restructure, Keith Anderson became the CEO of ScottishPower and Lindsay McQuade became CEO of Renewables.

The terms of reference of the SPREL Board are published at:
www.scottishpower.com/userfiles/file/Renewables-ToRs-Board-Directors-130603.pdf.

DIRECTORS' REPORT *continued*

CORPORATE GOVERNANCE *continued*

SPRH Board

The SPRH Board comprised the Chairman Aitor Moso Raigoso and five other directors as at 31 December 2018. The directors and their attendance at SPRH Board meetings held during the period under review (five meetings) are shown below:

Aitor Moso Raigoso (Chairman)	Attended all meetings
Neil Clitheroe (Chief Executive Officer)	Attended all meetings
Heather Chalmers	Attended three meetings
Óscar Fortis Pita	Attended all meetings
Félix Rojo Sevillano	Attended all meetings
Gregorio Relaño Cobián	Attended four meetings

The terms of reference of the SPRH Board are published at:
www.scottishpower.com/userfiles/file/SPGHL-Terms-of-Reference-Board-Directors-140224.pdf.

ScottishPower Board

The ScottishPower Board comprised the Chairman José Ignacio Sánchez Galán and eight other directors as at 31 December 2018. José Ignacio Sánchez Galán is also the Chairman and Chief Executive Officer of Iberdrola.

The directors of Scottish Power Limited are shown below:

José Ignacio Sánchez Galán	Chairman
Lord Kerr of Kinlochard GCMG	Vice Chairman, Independent non-executive director
Juan Carlos Rebollo Liceaga	
José Sainz Armada	
Keith Anderson	
Suzanne Fox	Independent non-executive director (appointed 12 December 2018)
Iñigo Fernández de Mesa Vargas	Independent non-executive director (appointed 12 December 2018)
Professor Sir James McDonald	Independent non-executive director
Dame Nicola Brewer	Independent non-executive director
Anthony Gardner	Independent non-executive director (resigned 19 February 2018)

ScottishPower Board meetings were held on five occasions during the year under review. Attendance by the directors was as follows:

José Ignacio Sánchez Galán	Attended all meetings
Lord Kerr of Kinlochard GCMG	Attended all meetings
Juan Carlos Rebollo Liceaga	Attended all meetings
José Sainz Armada	Attended all meetings
Keith Anderson	Attended all meeting
Suzanne Fox	Attended one meeting
Iñigo Fernández de Mesa Vargas	Attended one meeting
Professor Sir James McDonald	Attended four meetings
Dame Nicola Brewer	Attended all meetings
Anthony Gardner	Attended one meeting

ScottishPower Audit and Compliance Committee ("SP ACC")

The SP ACC, a permanent internal body, has an informative and consultative role, without executive functions, with powers of information, assessment and presentation of proposals to the ScottishPower Board within its scope of action, which is governed by the Articles of Association of Scottish Power Limited and by the terms of reference of the SP ACC. The SP ACC's responsibilities include:

- monitoring the financial reporting process for ScottishPower;
- monitoring the effectiveness of ScottishPower's internal control, internal audit, compliance and risk management systems;
- monitoring the statutory audit of the Annual Report and Accounts of ScottishPower; and
- monitoring the independence of the external auditor and recommending to the ScottishPower Board the appointment or reappointment of the auditor and the associated terms of reference.

The SP ACC's terms of reference are published at:
www.scottishpower.com/pages/audit_and_compliance_committee.aspx.

On 31 January 2018, the Board of Directors of SPENH, approved the establishment of the SPENH Audit and Compliance Committee ("SPENH ACC") to undertake the role and function of the SP ACC as they relate to the Regulated Networks business. The relationship between the SP ACC and the SPENH ACC is governed in accordance with their respective terms of reference.

The SPENH ACC's terms of reference are published at:
www.spenergynetworks.co.uk/userfiles/file/Terms_of_Reference_of_the_Audit_and_Compliance_Committee.pdf

DIRECTORS' REPORT *continued*

CORPORATE GOVERNANCE *continued*

ScottishPower Audit and Compliance Committee ("SP ACC") *continued*

Membership and attendance

The SP ACC met five times during the year under review. The members of the SP ACC and their attendance record are shown below:

Professor Sir James McDonald (Chairman)	External independent, attended all meetings
Dame Nicola Brewer	External independent, attended three meetings (appointed 11 July 2018)
Juan Carlos Rebollo Liceaga	Attended all meetings
Anthony Gardner	External independent, attended one meeting (resigned 19 February 2018)
Iñigo Fernández de Mesa Vargas	External independent, attended no meetings (appointed 12 December 2018).

In addition to the attendance set out above, the ScottishPower Control and Administration Director, Head of Internal Audit and the external auditor normally attend by invitation, all meetings of the SP ACC. Other members of senior management are also invited to attend as appropriate.

Matters considered by the SP ACC during 2018

The issues that the SP ACC specifically addressed are detailed in its report which is published at: www.scottishpower.com/pages/activities_report_of_the_audit_and_compliance_committee.aspx.

In addition to the issues detailed in the report above, the SP ACC in early 2019 also considered various matters which are relevant to the monitoring of the statutory audit of the Annual Report and Accounts of ScottishPower for 2018. In particular on 12 February 2019:

- the SP ACC reviewed the independence of the external auditor and submitted its conclusions on the same to the ScottishPower Board;
- as part of the SP ACC's supervision of the auditing of the Annual Report and Accounts, the external auditor appeared before the SP ACC to present its conclusions on the 2018 statutory audit; and
- the SP ACC reviewed the financial results to 31 December 2018 and submitted its conclusions on the same to the ScottishPower Board.

Significant financial statement reporting issues

In preparing the Annual Report and Accounts, there are a number of areas requiring management to apply judgement or a high degree of estimation. After discussion with management and the external auditor, the significant areas of judgement reviewed and considered by the SP ACC in relation to the 2018 Annual Report and Accounts, and how these were addressed are set out in the table below.

Significant financial judgements for the year ended 31 December 2018	How the SP ACC addressed these significant financial judgements
Accounting for group and parent company retirement benefit obligations The assumptions in relation to the cost to the group of providing future post-retirement benefits are set after consultation with qualified actuaries and can have a material impact on the financial position of the group. The costs, assets and liabilities of the group's defined benefit schemes are regularly reviewed. Advice is taken from independent actuaries and other specialists within the Iberdrola group on the IAS 19 valuation of the schemes including the complex assets. Further details are provided in Note 3L on page 49 and Note 16 on page 78.	The SP ACC were updated on the combined schemes' valuation and also considered the findings of the external auditor particularly in relation to the schemes' key assumptions and complexity of assets relative to current market practice. Following this review, the SP ACC supported this judgement.
Recognition of Retail accrued ('unbilled') revenue Revenue from energy sales to retail customers includes estimates of the value of electricity and gas supplied between the most recent meter reading and the period end. This is based on estimates and assumptions in relation to the consumption and its valuation. Further details are provided in Note 21 on page 86.	The SP ACC reviewed the estimation and valuation processes and assumptions applied in determining the recognition of accrued ('unbilled') revenue and were updated on the impact on the financial statements. This was with particular reference to domestic electricity and gas. The SP ACC also considered the findings of the external auditor. Following this review, the SP ACC supported this judgement.
Expected credit loss ("ECL") on Retail receivables The recoverability of the group's billed energy receivables in the Retail business function is a key judgement area given the risk of customer default. The level of the group's aged debt is monitored with the allowance for ECL being based on assumptions derived from estimated future cash flows, the ageing profile of the debt, prior experience and an assessment of the current economic environment. Further details are provided in Note 3H1.1(iii) on page 46 and Note 9(e) on page 67.	The SP ACC considered the assumptions impacting the allowance for ECL and related charges and the processes for debt collection and calculating the ECL. The SP ACC also considered the findings of the external auditor in this area. Following this review, the SP ACC supported this judgement.

DIRECTORS' REPORT *continued*

CORPORATE GOVERNANCE *continued*

Internal control

During the year under review, the directors of the company had overall responsibility for establishing and maintaining an adequate system of internal controls within the group and they participated in the review of internal controls over financial reporting, the preparation of consolidated Accounts and the certification process which took place on a ScottishPower group-wide basis. The effectiveness of the system within ScottishPower was kept under review through the work of the SP ACC. The system of internal control is designed to manage rather than eliminate risk. In pursuing these objectives, internal control only provide reasonable and not absolute assurance against material misstatement or loss.

A risk and control governance framework is in place across ScottishPower. The risk management framework and internal control system is subject to continuous review and development. The company is committed to ensuring that a proper control environment is maintained. There is a commitment to competence and integrity and to the communication of ethical values and control consciousness to managers and employees. HR policies underpin that commitment by a focus on enhancing job skills and promoting high standards of probity among staff. In addition, the appropriate organisational structure has been developed within which to control the businesses and to delegate authority and accountability, having regard to acceptable levels of risk. The company's expectations in this regard are set out in 'ScottishPower Code of Ethics', a policy document which aims to summarise some of the main legal, regulatory, cultural and business standards applicable to all employees. This document has been distributed to all employees of the company.

ScottishPower has a set of Anti-Bribery and Corruption Policies and Procedures, Crime Prevention and Anti-Fraud Guidelines, and Speaking Out Guidelines in place. Together with the Code of Ethics, these Policies, Procedures and Guidelines provide mechanisms to ensure that instances of fraud, bribery, corruption or other criminal or unethical behaviour are identified, reported and investigated. The Speaking Out guidelines incorporate a confidential external reporting service operated by an independent provider. These guidelines, which are applicable to employees and suppliers of the company, cover any incident, issue, behaviour or practice which does not comply with the Code of Ethics, including fraud, bribery, theft, misuse of company resources and conflicts of interest. There is also a process in existence within ScottishPower whereby all members of staff may report any financial irregularities to the Audit and Risk Supervision Committee of Iberdrola.

Identification and evaluation of risks and control objectives

During the year under review the ScottishPower governance structure was supported by risk policies adopted by the ScottishPower Board. These risk policies are adopted by the ScottishPower Board on an annual basis. ScottishPower business risk assessment teams and the independent group risk management function support the ScottishPower Board in the execution of due diligence and risk management. In addition, the SPENH, SPREL and SPRH Boards are responsible for ensuring that their respective businesses' risks are adequately assessed, monitored, mitigated and managed.

ScottishPower's strategy, which is adopted by the company, is to conduct business in a manner benefiting customers through balancing cost and risk while delivering shareholder value and protecting ScottishPower's performance and reputation by prudently managing the risks inherent in the business. ScottishPower develops and implements risk management policies and procedures, and promotes a robust control environment at all levels of the organisation.

The company identifies and assesses the key business risks associated with the achievement of its strategic objectives. Any key actions needed to further enhance the control environment are identified, along with the person responsible for the management of the specific risk.

External auditor

Annually, the SP ACC reviews the external auditor's audit plan and reviews and assesses the information provided by them confirming their independence and objectivity within the context of regulatory requirements and professional standards. The external auditor contributes a further independent perspective on certain aspects of the group's internal controls over financial reporting arising from their work and reports to the SP ACC if appropriate.

During 2018 the SP ACC approved the proposal to the ScottishPower Board on the terms of engagement of the external auditor KPMG LLP.

Auditor independence

The Audit, Risk and Supervision Committee of Iberdrola, which comprises non-executive directors, is responsible for the nomination of the external auditor. This committee and the external auditor have safeguards to avoid the possibility that the auditor's objectivity and independence could be compromised.

Where the work to be undertaken is of a nature that is generally considered reasonable to be completed by the external auditor for sound commercial and practical reasons, including confidentiality, the conduct of such work is permissible provided that all necessary internal governance has been met.

DIRECTORS' REPORT *continued*

CORPORATE GOVERNANCE *continued*

Auditor independence *continued*

Iberdrola Appointments and Remuneration Committees

There is no separate Appointments or Remuneration Committee within ScottishPower. Instead, appointments and remuneration matters relevant to ScottishPower and the company are dealt with by the Iberdrola Appointments Committee ("IAC") and the Iberdrola Remuneration Committee ("IRC"). The members of the IAC are:

María Helena Antolín Raybaud (Chairperson)	External independent
Iñigo Víctor de Oriol Ibarra	Other external
Sara de la Rica Goiricelaya	External independent

The members of the IRC are:

Inés Macho Stadler (Chairperson)	External independent
Iñigo Víctor de Oriol Ibarra	Other external
Juan Manuel González Serna	External independent

The IAC has the power to supervise the process of selection of directors and senior managers of the Iberdrola group companies. The Diversity Policy applied by the IAC is included within the IAC's terms of reference at:

www.iberdrola.com/wcorp/gc/prod/en_US/corporativos/docs/comision_nombramientos.pdf.

The Diversity Policy itself is published at:

www.iberdrola.com/wcorp/gc/prod/en_US/corporativos/docs/director_candidate_selection_policy.pdf.

Social, environmental and ethical matters

Social, environmental and ethical ("SEE") matters are included in the overall risk and control framework and in the Risk Report which is reviewed at the monthly management meetings. As such, regular account is taken of the strategic significance of SEE matters to the group, and the risks and opportunities arising from these issues that may have an impact on the group's short-term and long-term values are considered.

Further information regarding the SEE matters can be found in the 'Corporate Social Responsibility' section of the ScottishPower website at: www.scottishpower.com.

DIRECTORS

The directors who held office during the year were as follows:

Marion S Venman
David Wark
Donald Wright

DIRECTORS' INDEMNITY

In terms of the company's Articles of Association, a qualifying indemnity provision is in force for the benefit of all the directors of the company and of associated companies and has been in force during the financial year.

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND ACCOUNTS

The directors are responsible for preparing the Annual Report and Accounts in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent financial statements for each financial year. Under that law they are required to prepare the group financial statements in accordance with International Financial Reporting Standards as adopted by the European Union as at the date of approval of these Accounts and which are mandatory for the financial year ended 31 December 2018 ("IFRSs as adopted by the EU") and applicable law and have elected to prepare the parent company financial statements on the same basis.

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 group and parent company and of their profit or loss for that period. In preparing each of the group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and reliable;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- assess the group and parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate or to cease operations, or have no realistic alternative but to do so.

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

DIRECTORS' REPORT *continued*

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND ACCOUNTS *continued*

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

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

Disclosure of information to auditor

Each of the directors in office as at the date of this Annual Report and Accounts confirms that:

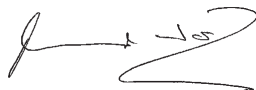
- so far as he or she is aware, there is no relevant audit information of which the company's auditor is unaware; and
- he or she has taken all the steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

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

AUDITOR

KPMG LLP were re-appointed as the auditor of the company for the period ended 31 December 2018.

BY ORDER OF THE BOARD



David Wark
Director
29 April 2019



INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SCOTTISH POWER UK PLC

1. Our opinion is unmodified

We have audited the financial statements of Scottish Power UK plc ("the Company") for the year ended 31 December 2018 which comprise the consolidated and company balance sheets, consolidated income statement, consolidated and company statements of comprehensive income, consolidated and company statements of changes in equity, consolidated and company cash flow statements and related notes, including the accounting policies in Note 3.

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2018 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the ScottishPower Audit and Compliance Committee ("SP ACC").

We were first appointed as auditor by the directors on 11 January 2018. The period of total uninterrupted engagement is for the two financial years ended 31 December 2018. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the Financial Reporting Council ("FRC") Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

Overview		
Materiality:	£28m (2017: £28m)	
Group financial statements as a whole	3.6% (2017: 5.4%) of Group profit before tax from continuing operations.	
Coverage	100% (2017: 100%) of Group profit before tax from continuing operations.	
Key audit matters		vs 2017
Recurring risks	IAS 19 provision for retirement benefit obligations	◀▶
	Valuation of Retail accrued ("unbilled") revenue	◀▶
	Valuation of Retail billed trade receivables	◀▶
Decrease in risk	Valuation of derivatives and hedging	▼

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SCOTTISH POWER UK PLC *continued*

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters, in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

	The risk	Our response
Retirement benefit obligations (Group and parent company) (Net deficit of £512.7 million; 2017: £564.8 million) Refer to page 19 (SP ACC statement), pages 49-50 (accounting policy) and pages 78-82 (financial disclosures).	Subjective valuation Relatively small changes in the actuarial assumptions underlying the valuation of the Group's defined benefit schemes could materially impact the deficit. A significant proportion of the combined schemes' assets are more complex in nature, including unlisted investments such as mezzanine and private debt instruments as well as properties and longevity swaps. The effect of these matters is that, as part of our risk assessment, we determined that the retirement benefit obligation has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements (Note 16(e) (iv)) disclose the sensitivity estimated by the Group.	Our procedures included: — Benchmarking assumptions: Challenging, with the support of our own actuarial specialists, the key assumptions applied, being the discount rate, inflation rate and mortality/life expectancy against externally derived data, including benchmarking against other schemes of a similar profile. — Tests of detail: We obtained the population of scheme assets and performed substantive tests of detail on a sample to determine whether they have been appropriately valued based on information from suitably qualified and objective third parties, whose credentials we have assessed. We obtained direct confirmations from third parties, such as investment managers, to support the valuation of a sample of relevant unlisted investments and property investments. — Assessing transparency: Considering the adequacy of the Group's disclosures in respect of the sensitivity of the deficit to these assumptions. Our results — We found the valuation of pension scheme assets and liabilities and the disclosures in respect of the sensitivity of the deficit to be acceptable.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SCOTTISH POWER UK PLC *continued*

2. Key audit matters: our assessment of risks of material misstatement *continued*

The risk	Our response
Valuation of Retail accrued ('unbilled') revenue (Gross carrying amount: £616.4 million; 2017: £666.9 million) (Provision and loss allowance: £20 million; 2017: £35 million) Refer to page 19 (SP ACC statement), page 86 (accounting policy) and page 86 (financial disclosures).	Subjective estimate The recognition of accrued ('unbilled') revenue is subject to a degree of estimation uncertainty as a result of the industry in which the Retail business operates. If actual meter readings are not available at the year-end, energy supplied to end customers is estimated based on standard external industry settlement data or internal information where settlement data is not yet available. The degree of estimation uncertainty diminishes over time as more accurate data becomes available and customers are billed. However, judgement is inherent in the valuation of accrued ('unbilled') revenue as at the year-end. The effect of these matters is that, as part of our risk assessment, we determined that the valuation of Retail accrued ('unbilled') revenue has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements (Note 21(b) (iv)) disclose the sensitivity estimated by the Group. Our procedures included: — Our sector experience: Evaluating the Group's key assumptions, particular those relating to units of energy supplied, price per unit and the provision in relation to energy volumes which are yet to reach final settlement, as follows: Comparing the Group's assumptions to external data, actual billing data and our own expectations based on our knowledge of the entity and experience of the industry in which it operates; Assessing the consistency of the Group's assumptions to those adopted in prior periods; — Control design, observation and operation: Testing the design, implementation and operating effectiveness of the Group's internal controls over: the algorithmic logic of the internal billing systems used to derive estimates of customer consumption, changes to pricing data, the validation of meter readings, the identification of billing exceptions and interfaces with the General Ledger; — Tests of details: Using Data and Analytics, performing a comparison of volume data to standard settlement data obtained directly from the external industry bodies; Comparing the Group's estimate as at the year-end to standard external industry settlement data and billing information available post year-end; Agreeing a sample of invoices issued to Industrial and Commercial customers to cash receipts; — Historical comparison: Evaluating the effectiveness of the Group's prior period estimation process by comparing the historical estimate to the actual outcome; — Expectations vs. outcomes: For Domestic and Small or medium-sized enterprise customers, developing an independent expectation of total Retail revenue using standard external industry settlement data, customer numbers data and tariff pricing information and comparing this to the total Retail revenue recognised; — Assessing transparency: Assessing the adequacy of the Group's disclosures about the degree of estimation involved in arriving at the valuation of accrued ('unbilled') revenue; Our results — We found the valuation and adequacy of disclosure of Retail accrued ('unbilled') revenue to be acceptable.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SCOTTISH POWER UK PLC *continued*

2. Key audit matters: our assessment of risks of material misstatement *continued*

	The risk	Our response
Valuation of Retail billed trade receivables (Gross carrying amount: £579.7 million; 2017: £567.8 million) (Loss allowance: £114.1 million; 2017: £109.9 million) Refer to page 19 (SP ACC statement), page 45 (accounting policy) and page 67 (financial disclosures).	Subjective estimate The Retail business carries significant exposure over the recoverability of billed customer receivables. An allowance for expected credit loss is provided based on an estimate of future cash flows. In arriving at this estimate, the Group considers the current ageing profile of debt, historical collections experience by payment plan, credit ratings for industrial and commercial customers and an assessment of current economic conditions, which is in line with the approach prescribed by IFRS 9. The effect of these matters is that, as part of our risk assessment, we determined that the valuation of Retail billed receivables has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements (Note 9 (e) (i)) disclose the sensitivity estimated by the Group.	Our procedures included: — Our sector experience: Evaluating the Group's key assumptions as follows: Benchmarking assumptions to industry methodology and our expectations based on our knowledge of the entity and experience of the industry in which it operates; Identifying and challenging changes in assumptions from prior periods and assessing whether there were any indicators of bias in the explanations provided to us; — Personnel interviews: Performing specific inquiries to assess whether the Group's judgements and estimates exhibited unconscious bias; — Control design, observation and operation: Testing the design, implementation and operating effectiveness of the Group's internal controls over: the relevant data elements used in the estimation of the loss allowance and the process for reconciling cash receipts and the General Ledger. — Tests of details: Assessing whether the loss allowance, recognised as at the year-end, was accurately and consistently calculated in accordance with the Group's methodology; Assessing the accuracy of the relevant ageing data components by agreeing a sample of issued invoices; Evaluating the level of cash collected, from Industrial and Commercial customers, subsequent to the year-end; — Historical comparisons: Evaluating the effectiveness of the Group's estimation process by comparing original estimates to the actual outcome over several periods; — Assessing transparency: Assessing the adequacy of the Group's disclosures about the degree of estimation involved in arriving at the allowance for expected credit loss; Our results — We found the expected credit loss allowance and the adequacy of disclosure for Retail billed trade receivables to be acceptable.

We continue to perform procedures over valuation of derivatives and hedging. However, following the implementation of IFRS 9 requirements and other changes in the profile of derivative instruments compared with prior years, we have not assessed this as one of the most significant risks in our current year audit and, therefore, it is not separately identified in our report this year.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SCOTTISH POWER UK PLC *continued*

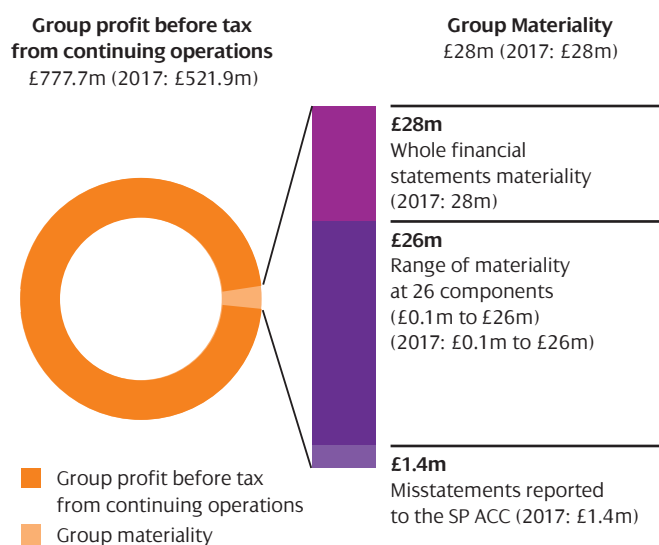
3. Our application of Group materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £28 million, determined with reference to a benchmark of Group profit before tax from continuing operations, normalised over the last five years due to fluctuations in the business cycle, of £581 million of which it represents 4.8%.

Materiality for the parent company financial statements was set with reference to total assets but capped at £26 million due to the level of Group materiality.

We agreed to report to the SP ACC any corrected or uncorrected identified misstatements exceeding £1.4 million, in addition to other identified misstatements that warranted reporting on qualitative grounds.

All of the Group's components were subject to full scope audit procedures performed in the UK by the Group audit team, these components represented 100% (2017: 100%) of Group revenue, profit before tax and total assets.



INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SCOTTISH POWER UK PLC *continued*

4. We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as they have concluded that the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Company will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Company's business model, including the impact of a disorderly Brexit, and analysed how those risks might affect the Company's financial resources or ability to continue operations over the going concern period. We evaluated those risks and concluded that they were not significant enough to require us to perform additional audit procedures.

Based on this work, we are required to report to you if we have anything material to add or draw attention to in relation to the directors' statement in Note 35 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Company's use of that basis for a period of at least twelve months from the date of approval of the financial statements.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

5. We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and directors' report

Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

6. We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion:

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

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on pages 21 and 22, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

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

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SCOTTISH POWER UK PLC *continued*

7. Respective responsibilities *continued*

Auditor's responsibilities *continued*

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience and through discussion with the directors and other management (as required by auditing standards), and from inspection of the Group's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Group's licences to operate. We identified the following areas as those most likely to have such an effect: health and safety, anti-bribery, employment law, energy market regulations and certain aspects of company legislation recognising the nature of the Group's activities and its legal form. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. These limited procedures did not identify actual or suspected non-compliance.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

8. The purpose of our audit work and to whom we owe our responsibilities

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



**Philip Charles (Senior Statutory Auditor
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants**

319 St. Vincent Street
Glasgow
G2 5AS
29 April 2018

SCOTTISH POWER UK PLC
CONSOLIDATED BALANCE SHEET
at 31 December 2018

	Notes	2018 £m	2017 Restated* £m
ASSETS			
NON-CURRENT ASSETS			
Intangible assets		611.0	535.1
Goodwill	6	364.6	364.6
Other intangible assets	6	246.4	170.5
Property, plant and equipment		12,937.6	12,922.2
Property, plant and equipment in use	7	10,935.4	11,446.1
Property, plant and equipment in the course of construction	7	2,002.2	1,476.1
Financial assets		91.7	71.1
Investments in joint ventures	8	6.9	5.6
Other investments	9	1.1	1.1
Finance lease receivables	9	–	0.1
Derivative financial instruments	9	83.7	64.3
Trade and other receivables	10	72.4	53.2
NON-CURRENT ASSETS		13,712.7	13,581.6
CURRENT ASSETS			
Inventories	11	770.6	464.0
Trade and other receivables	10	1,440.3	1,513.7
Financial assets		151.0	107.7
Finance lease receivables	9	–	0.4
Derivative financial instruments	9	151.0	107.3
Cash and short-term deposits	9	739.5	45.6
CURRENT ASSETS		3,101.4	2,131.0
TOTAL ASSETS		16,814.1	15,712.6

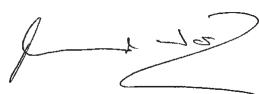
* Comparative figures have been restated (refer to Note 2).

SCOTTISH POWER UK PLC
CONSOLIDATED BALANCE SHEET *continued*
at 31 December 2018

	Notes	2018 £m	2017 Restated* £m
EQUITY AND LIABILITIES			
EQUITY			
Of shareholders of the parent	13	5,954.1	5,280.5
Share capital	12, 13	2,192.0	2,192.0
Share premium	13	398.2	398.2
Hedge reserve	13	98.9	86.4
Other reserves	13	420.5	14.0
Retained earnings	13	2,844.5	2,589.9
Of non-controlling interests	14	1.0	0.9
TOTAL EQUITY		5,955.1	5,281.4
NON-CURRENT LIABILITIES			
Deferred income	15	1,213.0	1,183.6
Provisions		721.0	796.6
Provisions for retirement benefit obligations	16	512.7	564.8
Other provisions	17	208.3	231.8
Bank borrowings and other financial liabilities		2,741.3	2,986.9
Loans and other borrowings	18	2,737.7	2,986.4
Derivative financial instruments	9	3.6	0.5
Trade and other payables	19	35.3	33.7
Deferred tax liabilities	20	746.4	738.2
NON-CURRENT LIABILITIES		5,457.0	5,739.0
CURRENT LIABILITIES			
Provisions	17	342.7	360.9
Bank borrowings and other financial liabilities		3,509.7	2,750.3
Loans and other borrowings	18	3,409.7	2,681.4
Derivative financial instruments	9	100.0	68.9
Trade and other payables	19	1,468.4	1,550.7
Current tax liabilities		81.2	30.3
CURRENT LIABILITIES		5,402.0	4,692.2
TOTAL LIABILITIES		10,859.0	10,431.2
TOTAL EQUITY AND LIABILITIES		16,814.1	15,712.6

* Comparative figures have been restated (refer to Note 2).

Authorised for issue by the Board and signed on its behalf on 29 April 2019.



David Wark
Director

The accompanying Notes 1 to 35 are an integral part of the consolidated balance sheet at 31 December 2018.

SCOTTISH POWER UK PLC
CONSOLIDATED INCOME STATEMENT
for the year ended 31 December 2018

	Notes	2018 £m	2017 Restated* £m
CONTINUING OPERATIONS			
Revenue	4, 21	4,993.7	4,881.3
Procurements		(2,670.2)	(2,804.5)
GROSS MARGIN		2,323.5	2,076.8
NET OPERATING EXPENSES		(621.9)	(684.0)
Net personnel expenses	22	(230.5)	(264.3)
Staff costs	22	(388.3)	(405.9)
Capitalised staff costs	22	157.8	141.6
Net external services		(391.4)	(419.7)
External services		(478.7)	(486.6)
Other operating income		87.3	66.9
Taxes other than income tax	23	(187.3)	(212.5)
GROSS OPERATING PROFIT		1,514.3	1,180.3
Impairment losses on trade and other receivables		(59.5)	(68.0)
Depreciation and amortisation charge, allowances and provisions	24	(513.0)	(459.7)
OPERATING PROFIT		941.8	652.6
Result of companies accounted for using the equity method	8	1.3	0.9
Gains on disposal of non-current assets		1.4	0.4
Losses on disposal of non-current assets		–	(0.1)
Gain on disposal of subsidiaries	34	–	20.2
Finance income	25	12.1	15.4
Finance costs	26	(178.9)	(167.5)
PROFIT BEFORE TAX		777.7	521.9
Income tax	27	(149.9)	(93.5)
NET PROFIT FOR THE YEAR FROM CONTINUING OPERATIONS		627.8	428.4
DISCONTINUED OPERATIONS			
Profit/(loss) from discontinued operation, net of tax	28	190.8	(2.3)
NET PROFIT FOR THE YEAR		818.6	426.1
Non-controlling interests	14	(0.3)	(0.2)
NET PROFIT FOR THE YEAR ATTRIBUTABLE TO THE PARENT		818.3	425.9

*Comparative figures have been restated (refer to Note 2 and Note 28).

SCOTTISH POWER UK PLC
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
for the year ended 31 December 2018

	Note	2018 £m	2017 £m
NET PROFIT FOR THE YEAR		818.6	426.1
OTHER COMPREHENSIVE INCOME			
Items that may be subsequently reclassified to the income statement:			
Cash flow hedges:			
Change in the value of cash flow hedges	13	13.9	27.9
Tax relating to cash flow hedges	13	(2.7)	(5.3)
		11.2	22.6
Items that will not be reclassified to the income statement:			
Actuarial losses on retirement benefits:			
Actuarial losses on retirement benefits	13	(48.2)	(222.9)
Tax relating to actuarial losses on retirement benefits	13	8.2	36.4
Cash flow hedges:			
Change in the value of cash flow hedges	13	1.6	(19.0)
Tax relating to cash flow hedges	13	(0.3)	3.6
		(38.7)	(201.9)
OTHER COMPREHENSIVE INCOME FOR THE YEAR		(27.5)	(179.3)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		791.1	246.8
Total comprehensive income for the year attributable to equity holders of the parent		790.8	246.6
Total comprehensive income for the year attributable to non-controlling interests		0.3	0.2
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		791.1	246.8
Continuing operations		599.7	248.7
Discontinued operations		191.1	(2.1)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR ATTRIBUTABLE TO EQUITY HOLDER OF THE PARENT		790.8	246.6

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
for the year ended 31 December 2018

	Attributable to equity holder of the parent							Non-controlling interests £m	Total equity £m
	Share capital £m	Share premium £m	Hedge reserve £m	Translation reserve £m	Other reserves £m	Retained earnings £m	Total £m		
At 1 January 2017	872.0	398.2	79.2	0.3	14.0	2,650.5	4,014.2	0.6	4,014.8
Total comprehensive income for the year	–	–	7.2	–	–	239.4	246.6	0.2	246.8
Exchange movement on translation of overseas results and net assets	–	–	–	0.2	–	–	0.2	–	0.2
Group restructuring	–	–	–	(0.5)	–	–	(0.5)	0.1	(0.4)
Share capital issued (refer to Note 13(a))	1,320.0	–	–	–	–	–	1,320.0	–	1,320.0
Dividends	–	–	–	–	–	(300.0)	(300.0)	–	(300.0)
At 1 January 2018	2,192.0	398.2	86.4	–	14.0	2,589.9	5,280.5	0.9	5,281.4
Adjustments due to IFRS 9 (refer to Note 2A3.2)	–	–	–	–	–	(1.3)	(1.3)	–	(1.3)
Adjustments due to IFRS 15 (refer to Note 2A3.1)	–	–	–	–	–	40.8	40.8	–	40.8
Adjusted balance at 1 January 2018	2,192.0	398.2	86.4	–	14.0	2,629.4	5,320.0	0.9	5,320.9
Total comprehensive income for the year	–	–	12.5	–	–	778.3	790.8	0.3	791.1
Capital contribution (refer to Note 13(e))	–	–	–	–	412.2	–	412.2	–	412.2
Realisation of revaluation reserve	–	–	–	–	(5.7)	–	(5.7)	–	(5.7)
Dividends	–	–	–	–	–	(563.2)	(563.2)	(0.2)	(563.4)
At 31 December 2018	2,192.0	398.2	98.9	–	420.5	2,844.5	5,954.1	1.0	5,955.1

The accompanying Notes 1 to 35 are an integral part of the consolidated statement of comprehensive income and the consolidated statement of changes in equity for the year ended 31 December 2018.

SCOTTISH POWER UK PLC
CONSOLIDATED CASH FLOW STATEMENT
for the year ended 31 December 2018

	2018 £m	2017 Restated* £m
Cash flows from operating activities		
Profit before tax – continuing operations	777.7	521.9
Profit/(loss) before tax – discontinued operations	186.3	(5.4)
Total profit before tax	964.0	516.5
Adjustments for:		
Depreciation, amortisation and impairment	557.9	498.3
Research and development expenditure credit	(2.7)	–
Change in provisions	476.0	423.0
Result of companies accounted for using the equity method	(1.3)	(0.9)
Capital grants and transfer of assets from customers	(39.2)	(35.3)
Finance income and costs	171.4	158.8
Net losses on disposal/write-off non-current assets	1.8	3.8
Gain on disposal of subsidiaries (pre-transaction costs)	(177.1)	(20.2)
Movement in retirement benefits	(107.6)	(110.0)
Net fair value (losses)/gains on operating derivatives	(6.5)	23.9
Movement in deferred income	(0.1)	(0.1)
Movement in plant maintenance stocks	2.3	(0.6)
Changes in working capital:		
Change in trade and other receivables	(146.4)	(70.8)
Change in inventories	(818.1)	(586.2)
Change in trade and other payables	108.5	96.6
Provisions paid	(12.5)	(9.8)
Assets received from customers	65.3	107.3
Income taxes paid	(40.7)	(37.5)
Net cash flows from operating activities (i)	995.0	956.8
Cash flows from investing activities		
Interest received	10.2	10.3
Dividends received	0.2	0.1
Investments in intangible assets	(92.1)	(44.5)
Investments in property, plant and equipment (net of capital grants)	(1,144.2)	(1,569.9)
Disposal of jointly controlled entities	–	4.0
Proceeds from disposal of property, plant and equipment	3.9	33.4
Net proceeds received from disposal of subsidiaries	686.9	21.8
Cash disposed	–	(1.5)
Decrease in amounts due from Iberdrola group companies – current loans receivable	113.6	112.0
Net cash flows from investing activities (ii)	(421.5)	(1,434.3)
Cash flows from financing activities		
Increase/(decrease) in amounts due to Iberdrola group companies – current loans payable	862.0	(1,147.3)
Decrease in amounts due to Iberdrola group companies – non-current loans payable	–	989.7
Cash inflows from issuance of borrowings (including loan with joint venture)	7.2	1.1
Share capital issued	–	1,320.0
Dividends paid to company's equity holders	(563.2)	(300.0)
Dividends paid to non-controlling interests	(0.2)	–
Interest paid	(185.3)	(169.7)
Repayments of borrowing	–	(206.3)
Net cash flows from financing activities (iii)	120.5	487.5
Net increase/(decrease) in cash and cash equivalents (i)+(ii)+(iii)	694.0	10.0
Cash and cash equivalents at beginning of year	45.5	35.5
Cash and cash equivalents at end of year	739.5	45.5
Cash and cash equivalents at end of year comprises:		
Consolidated balance sheet cash and short-term deposits	739.5	45.6
Bank overdraft	–	(0.1)
Consolidated cash flow statement cash and cash equivalents	739.5	45.5

* Comparative figures have been restated (refer to Note 2).

The accompanying Notes 1 to 35 are an integral part of the consolidated cash flow statement for the year ended 31 December 2018.

NOTES TO THE CONSOLIDATED ACCOUNTS

31 December 2018

1 GROUP ACTIVITIES

A. COMPANY INFORMATION

Scottish Power UK plc

The group's holding company is Scottish Power UK plc (registered company number SC117120), a private company limited by shares. It is incorporated in Scotland and its registered address is 320 St. Vincent Street, Glasgow, Scotland, G2 5AD.

B. GROUP INFORMATION

The group provides electricity transmission and distribution services in the UK and conducts renewable energy activities across the UK and Republic of Ireland (and until 1 August 2017, in France and Germany). In addition, it supplies gas and electricity to homes and businesses across the UK; operates gas storage facilities and undertakes associated energy management activities in the UK. Until 31 December 2018, the group also operated a portfolio of CCGT and hydro-electric power stations.

As described in Note 4, in line with IFRS 8 'Operating Segments' ("IFRS 8"), the group defines operating segments based on a combination of factors, principally differences in products and services and the regulatory environment in which the business operates. The group reported three principal segments during the year: Energy Networks, Renewables and Energy Wholesale and Retail.

Energy Networks

The transmission and distribution businesses within the group's authorised area in the south of Scotland and the distribution business of Manweb operating in Cheshire, Merseyside, North Shropshire and North Wales.

Renewables

The development and construction of renewable energy generation assets and the generation and sale of electricity and ROCs from those assets.

Energy Wholesale and Retail

The purchase of electricity and gas for onward sale to customers; and the optimisation of gas storage. The business is also involved in the sale of electricity to market participants in the UK and the sale of electricity and gas to industrial and domestic customers, together with related billing and collection activities. Until 31 December 2018, the business was also engaged in the generation of electricity from the group's own power stations and the purchase of external supplies of gas for the generation of electricity.

2 BASIS OF PREPARATION

A. BASIS OF PREPARATION OF THE ACCOUNTS

The company is required by law to prepare accounts for both the company and the group and to deliver them to the Registrar of Companies. Both the group (being these consolidated Accounts) and the company's individual Accounts, have been prepared in accordance with International Financial Reporting Standards, as adopted by the EU as at the date of approval of these Accounts and which are mandatory for the financial year ended 31 December 2018 (IFRSs as adopted by the EU). Both the group and company Accounts are prepared in accordance with the Accounting Policies set out in Note 3. Monetary amounts are presented in pounds Sterling and are rounded to the nearest hundred thousand unless otherwise indicated.

A1 CHANGES IN PRESENTATION

A1.1 PLANT MAINTENANCE ASSETS

In prior years, plant maintenance spares were included within property, plant and equipment. During the year, the directors have reviewed the classification of plant maintenance spares within the balance sheet and concluded that such assets should be recorded within inventories. The 2017 consolidated balance sheet has therefore been adjusted to decrease property, plant and equipment and increase other inventories by £11.9 million. This restatement has had no impact on the net profit for the year shown on the consolidated income statement and statement of comprehensive income nor the net assets position shown on the balance sheet.

A1.2 FINAL CUSTOMER CREDITS

In prior years, credit balances in relation to customers who have left Energy Retail for another energy supplier (final customer credits) were netted within Trade and other receivables. During the year, the directors have reviewed the classification of final customer credits within the balance sheet and concluded that such balances should be recorded within Trade and other payables. The 2017 consolidated balance sheet has therefore been adjusted to increase Trade and other receivables and Trade and other payables by £35.8 million. This restatement has had no impact on the net profit for the year shown on the consolidated income statement and statement of comprehensive income nor the net assets position shown on the balance sheet.

A1.3 TRANSFERS OF ASSETS FROM CUSTOMERS

The group earns income arising from transfers of assets from customers, as it is common for utilities to receive contributions from customers so that they can be connected to a network or receive ongoing access to a supply of services from them. In line with IFRIC 18 'Transfer of Assets from Customers', this income had previously been presented within Other operating income in the consolidated income statement. However, in order to provide better information to the users of the financial statements and classify all customer-derived income consistently under the scope of IFRS 15 'Revenue from Contracts with customers', management have opted to reclassify this stream of income, and as such, income arising from transfers of assets from customers is now presented within Revenue in the consolidated income statement. The prior year consolidated income statement has been restated accordingly. The effect of this change in presentation has been to decrease the prior year Other operating income and increase Revenue by £35.3 million. This restatement has had no impact on the net profit for the year shown on the consolidated income statement and statement of comprehensive income nor the net assets position shown on the consolidated balance sheet.

A2. CHANGE IN ACCOUNTING ESTIMATE

A2.1 CHANGE IN USEFUL LIFE OF COMPUTER SOFTWARE SYSTEM

During 2018, the group performed a review of the useful lives of its computer software systems; the analysis reviewed both internal and external sources of information. As a result of this review, the group has increased the useful life of its customer relationship management system to eight years compared to the five years previously applied. This change in estimate has been applied prospectively from 1 January 2018. The impact of this change has been to reduce the amortisation charge of the group for the current year by £27.8 million. It is impracticable to estimate the effect of this change on future periods.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

2 BASIS OF PREPARATION *continued*

A. BASIS OF PREPARATION OF THE ACCOUNTS *continued*

A3. EFFECT OF INITIAL APPLICATION OF IFRS 15 AND IFRS 9

This is the first set of the group's annual financial statements in which IFRS 15 'Revenue from Contracts with Customers' and IFRS 9 'Financial Instruments' have been applied. The nature and effect of the changes as a result of the implementation of these standards is described below.

A3.1 EFFECT OF INITIAL APPLICATION OF IFRS 15

The group has applied IFRS 15 for the first time using the cumulative effect method i.e. by recognising the cumulative effect of initially applying IFRS 15 as an adjustment to the opening balance of equity at 1 January 2018. Therefore, the comparative information has not been restated and continues to be reported under IAS 18 'Revenue' and the IFRS 15 disclosure requirements have not been applied to comparative information.

The application of IFRS 15 has not had a significant impact on the group's revenue recognition. The only impact on the group relates to the incremental costs of obtaining certain customer contracts, principally sales commissions for certain customer classes, which prior to the implementation of IFRS 15, were recognised as costs within External services in the consolidated income statement. Under IFRS 15, the group capitalises these commission fees as costs of obtaining a contract when they are incremental and if they are expected to be recovered. These are recorded as a separate asset class within Other intangible assets and amortised on a systematic basis according to the average expected life of contracts with customers that are associated with such costs. This will be kept under review to consider changes to external market factors.

The table below illustrates the impact of the initial application of IFRS 15 on the opening balances at 1 January 2018.

	Adjustments due to IFRS 15 £m
Intangible assets	50.1
Other intangible assets	50.1
NON-CURRENT ASSETS	50.1
TOTAL ASSETS	50.1
Of shareholders of the parent	40.8
Retained earnings	40.8
TOTAL EQUITY	40.8
Deferred tax liabilities	9.3
NON-CURRENT LIABILITIES	9.3
TOTAL LIABILITIES	9.3
TOTAL EQUITY AND LIABILITIES	50.1

The following tables set out the amount by which each financial statement line item is affected by the initial application of IFRS 15 as at and for the year ending 31 December 2018.

(a) Consolidated balance sheet as at 31 December 2018

	As reported £m	Adjustments due to IFRS 15 £m	Balances without application of IFRS 15 £m
Intangible assets	611.0	(77.8)	533.2
Other intangible assets	246.4	(77.8)	168.6
NON-CURRENT ASSETS	13,712.7	(77.8)	13,634.9
TOTAL ASSETS	16,814.1	(77.8)	16,736.3
Of shareholders of the parent	5,954.1	(63.3)	5,890.8
Retained earnings	2,844.5	(63.3)	2,781.2
TOTAL EQUITY	5,955.1	(63.3)	5,891.8
Deferred tax liabilities	746.4	(5.5)	740.9
NON-CURRENT LIABILITIES	5,457.0	(5.5)	5,451.5
Current tax liabilities	81.2	(9.0)	72.2
CURRENT LIABILITIES	5,402.0	(9.0)	5,393.0
TOTAL LIABILITIES	10,859.0	(14.5)	10,844.5
TOTAL EQUITY AND LIABILITIES	16,814.1	(77.8)	16,736.3

(b) Consolidated income statement for the year ended 31 December 2018

	As reported £m	Adjustments due to IFRS 15 £m	Results without application of IFRS 15 £m
CONTINUING OPERATIONS			
NET OPERATING EXPENSES	(621.9)	(53.2)	(675.1)
Net external expenses	(391.4)	(53.2)	(444.6)
External services	(478.7)	(53.2)	(531.9)
GROSS OPERATING PROFIT	1,514.3	(53.2)	1,461.1
Depreciation and amortisation charge, allowances and provisions	(513.0)	25.5	(487.5)
OPERATING PROFIT	941.8	(27.7)	914.1
PROFIT BEFORE TAX	777.7	(27.7)	750.0
Income Tax	(149.9)	5.2	(144.7)
NET PROFIT FOR THE YEAR FROM CONTINUING OPERATIONS	627.8	(22.5)	605.3

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

2 BASIS OF PREPARATION *continued*

A. BASIS OF PREPARATION OF THE ACCOUNTS *continued*

A3. EFFECT OF INITIAL APPLICATION OF IFRS 15 AND IFRS 9 *continued*

A3.1 EFFECT OF INITIAL APPLICATION OF IFRS 15 *continued*

(c) Cash flow statement for the year ended 31 December 2018

	As reported £m	Adjustments due to IFRS 15 £m	Results without application of IFRS 15 £m
Profit before tax	964.0	(27.7)	936.3
Adjustments for:			
Depreciation, amortisation and impairment	557.9	(25.5)	532.4
Net cash flows from operating activities (i)	995.0	(53.2)	941.8
Investments in intangible assets	(92.1)	53.2	(38.9)
Net cash flows from investing activities (ii)	(421.5)	53.2	(368.3)
Net cash flows from financing activities (iii)	120.5	–	120.5
Net increase in cash and cash equivalents (i) + (ii) + (iii)	694.0	–	694.0

A3.2 EFFECT OF INITIAL APPLICATION OF IFRS 9

IFRS 9 'Financial Instruments' replaces IAS 39 'Financial Instruments: Recognition and Measurement' for annual periods beginning on or after 1 January 2018, bringing together all three aspects of the accounting for financial instruments: classification and measurement; impairment; and hedge accounting.

As a result of the initial application of IFRS 9, the group has applied the consequential amendments to IAS 1 'Presentation of Financial Statements', which requires impairment of financial assets to be presented in a separate line item in the consolidated income statement. Previously, the group's approach was to include the impairment of trade and other receivables within Depreciation and amortisation charge, allowances and provisions. Consequently, the group reclassified impairment losses amounting to £68.0 million, recognised under IAS 39, from Depreciation and amortisation charge, allowances and provisions to Impairment losses on trade and other receivables in the consolidated income statement for the year ended 31 December 2017.

Impairment losses on other financial assets continue to be presented under Finance costs in the consolidated income statement, similar to their presentation under IAS 39, and are not presented separately in the consolidated income statement on the grounds of materiality.

With the exception of hedge accounting, which the group applied prospectively, the group has applied IFRS 9 retrospectively, with the initial application date of 1 January 2018. In line with consequential amendments to IFRS 7 'Financial Instruments: Disclosures', the group has elected not to restate comparative information. As a result, the comparative information provided continues to be accounted for in accordance with the group's previous accounting policy under IAS 39.

The table below illustrates the impact of the initial application of IFRS 9 on the opening balances of the group and the company at 1 January 2018.

	Adjustments due to IFRS 9	
	Group £m	Company £m
Retained earnings		
Recognition of Expected Credit Losses ("ECLs") under IFRS 9	(1.7)	(2.2)
Related tax	0.4	0.4
Impact at 1 January 2018	(1.3)	(1.8)

(a) Classification and measurement of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income ("FVOCI") and fair value through profit or loss ("FVTPL"). The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. IFRS 9 eliminates the previous IAS 39 categories of held to maturity, loans and receivables and available for sale. IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities. As stated above, with the exception of hedge accounting, the group has applied the classification and measurement requirements retrospectively, with initial application on 1 January 2018, thus the figures for comparative periods have not been restated.

Financial assets

The group has classified its financial assets into the following categories:

- financial assets held at amortised cost; and
- financial assets at FVTPL.

A description of these categories of financial assets can be found in Note 3H.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

2 BASIS OF PREPARATION *continued*

A. BASIS OF PREPARATION OF THE ACCOUNTS *continued*

A3. EFFECT OF INITIAL APPLICATION OF IFRS 15 AND IFRS 9 *continued*

A3.2 EFFECT OF INITIAL APPLICATION OF IFRS 9 *continued*

(a) Classification and measurement of financial assets and financial liabilities *continued*

The following table and the accompanying notes explain the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the group's financial assets at 1 January 2018. The effect of adopting IFRS 9 on the carrying amounts of financial assets at 1 January 2018 relates solely to the new impairment requirements.

Financial asset	Original classification under IAS 39	New classification under IFRS 9	Notes	Original carrying value under IAS 39 £m	New carrying value under IFRS 9 £m
Finance lease receivables	N/A	N/A	(i), (ii)	0.5	0.5
Derivative financial instruments	Fair value-hedging instrument	Fair value-hedging instrument	(iii)	171.6	171.6
Current receivables	Loans and receivables	Amortised cost	(iv), (v)	1,435.7	1,434.1
Non-current receivables	Loans and receivables	Amortised cost	(iv), (v)	39.1	39.0
Other investments	Available for sale	FVTPL	(vi)	1.1	1.1
Cash and short-term deposits	Loans and receivables	Amortised cost	(i), (v)	45.6	45.6
Total financial assets				1,693.6	1,691.9

- (i) While these balances are also subject to the impairment requirements of IFRS 9, the identified impairment loss was less than £0.1 million.
- (ii) IAS 39 only applied to finance lease receivables in respect of derecognition and impairment. The carrying amount of finance lease receivables is calculated as set out in Note 3F. IFRS 9 requires the new ECL methodology to be applied to leases within the scope of IAS 17 'Leases'.
- (iii) Derivative financial instruments continue to be held at fair value. Within derivative financial instruments there are hedging derivatives with a value of £119.0 million and non-hedging derivatives with a fair value of £300.0 million. These balances are offset by a netting adjustment of £247.4 million.
- (iv) Current and non-current receivables include trade receivables (including accrued income), other receivables and loans, trade, other and interest receivables due from Iberdrola group companies and jointly controlled entities. Refer to Notes 9(a) and 10.
- (v) Balances that were classified as Loans and receivables under IAS 39 are now classified at amortised cost. An increase of £1.7 million in the allowance for impairment over these balances was recognised in the opening retained earnings at 1 January 2018 on transition to IFRS 9 (refer to footnote (b) below).
- (vi) The group has irrevocably elected that other investments existing at the time of the initial application of IFRS 9 should be classified as FVTPL where changes in fair value are recognised under Finance income and Finance costs. Previously revaluation surpluses and deficits were recognised in the statement of comprehensive income.

Refer to Note 9 for details of the group's financial assets in the current year.

The classification and measurement requirements of IFRS 9 did not have a significant impact on the group. Most financial assets continue to be valued at amortised cost and derivative financial instruments continue to be valued at fair value as was the case under the previously applied IAS 39. Other investments which were previously measured as Available for sale securities are now valued at FVTPL.

Financial liabilities

The classification of the group's financial liabilities has not undergone any changes with respect to the application of IFRS 9.

Consequently the application of IFRS 9 has not had a significant effect on the group's accounting policies related to financial liabilities and derivative financial instruments (for derivatives that are used as hedging instruments (refer to footnote (c) overleaf)).

For an explanation of how the group classifies and measures financial liabilities and accounts for related gains and losses under IFRS 9, refer to Note 3H1.2.

(b) Impairment of financial assets

The application of IFRS 9 has changed the group's accounting for impairment losses for financial assets by replacing IAS 39's incurred loss approach with a new ECL approach. This new impairment model applies to financial assets measured at amortised cost including finance lease receivables. Other financial assets measured at FVTPL are out of scope. Under IFRS 9, credit losses are recognised earlier than under IAS 39 (refer to Note 3H1.1).

The group applies the general model approach for calculation of ECLs on financial assets measured at amortised cost other than for trade receivables and finance lease receivables, where the simplified model approach is applied:

Brief explanations of each model are set out below:

- i. **General Model:** The loss allowance is measured at an amount equal to twelve month ECL. However, if the credit risk on that financial instrument has increased significantly since initial recognition, the loss allowance is measured at an amount equal to the lifetime ECL.
- ii. **Simplified Model:** The loss allowance is measured at an amount equal to a lifetime ECL. The group has adopted the practical expedient whereby it calculates the ECL on trade receivables using a provision matrix based on its historical credit loss experience and where possible readily available forecast information.

Additional information about how the group measures the allowance for impairment is described in Note 9. The group has adopted the impairment requirements retrospectively, with initial application on 1 January 2018, thus opting not to restate the figures for comparative periods.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

2 BASIS OF PREPARATION *continued*

A. BASIS OF PREPARATION OF THE ACCOUNTS *continued*

A3. EFFECT OF INITIAL APPLICATION OF IFRS 15 AND IFRS 9 *continued*

A3.2 EFFECT OF INITIAL APPLICATION OF IFRS 9 *continued*

(b) Impairment of financial assets *continued*

The application of IFRS 9's impairment requirements at 1 January 2018 results in an additional allowance for impairment for the group and company as follows:

	Note	Group £m	Company £m
Loss allowance at 31 December 2017 under IAS 39 (trade and other receivables)		128.4	0.3
Additional impairment recognised at 1 January 2018 on:			
Finance lease receivables	(i)	–	–
Current and non-current receivables as at 31 December 2017		1.7	2.2
Cash and short-term deposits	(i)	–	–
Loss allowance at 1 January 2018 under IFRS 9		130.1	2.5

(i) Whilst these balances are also subject to the impairment requirements of IFRS 9, the identified impairment loss was less than £0.1 million.

(c) Hedge accounting

The group has elected to apply the new general hedge accounting model in IFRS 9. This requires the group to ensure that hedge accounting relationships are aligned with its risk management objectives and strategy and to apply a more qualitative and forward-looking approach to assessing hedge effectiveness.

The group uses forward contracts to hedge the variability in cash flows arising from changes in foreign exchange rates relating to foreign currency borrowings, non-financial asset purchases and commodity purchases.

Before the application of IFRS 9, the group designated the change in fair value of the spot element of treasury related forward contracts (hedging the value of currency denominated intercompany loans) in the income statement. The movement in the value of forward points was recorded in Finance income or Finance costs in the income statement. Upon application of IFRS 9, the group continues to designate only the spot element of treasury related forward exchange contracts as the hedging instrument. However the forward element is now recognised in Other comprehensive income ("OCI") and accumulated within the cost of hedging reserve within the cash flow hedge reserve. This change only applies prospectively from the date of initial application of IFRS 9 and has no impact on the presentation of comparative figures.

There has been no change to the accounting treatment of forward exchange contracts used to hedge commodity purchases or asset purchases.

At the date of initial application, all of the group's existing hedging relationships were eligible to be treated as continuing hedging relationships.

For an explanation of how the group applies hedge accounting under IFRS 9, see Note 3H1.3.

B. ACCOUNTING STANDARDS

B1. IMPACT OF NEW IFRS

In preparing these Accounts, the group has applied all relevant International Accounting Standards ("IAS"), International Financial Reporting Standards ("IFRS") and International Financial Reporting Interpretations Committee ("IFRIC") collectively referred to as IFRS that have been adopted by the EU as of the date of approval of these Accounts and that are mandatory for the financial year ended 31 December 2018.

For the year ended 31 December 2018, the group has applied the following amendments for the first time:

Standard	Notes
• Annual Improvements to IFRS Standards 2014 –2016 Cycle	(a), (b)
• IFRS 15 'Revenue from Contracts with Customers' (including 'Amendments to IFRS 15: Effective date of IFRS 15' and 'Clarifications to IFRS 15 Revenue from Contracts with Customers')	(c)
• IFRS 9 'Financial Instruments'	(d)
• Amendments to IAS 40 'Investment Property: Transfers of Investment Property'	(a)
• Amendments to IFRS 2 'Share-based Payments: Clarification and Measurement of Share-based Payment Transactions'	(a)
• Amendments to IFRS 4 'Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts'	(a)
• IFRIC 22 'Foreign Currency Transactions and Advance Consideration'	(a)

(a) The application of these pronouncements has not had a material impact on the group's accounting policies, financial position or performance.

(b) This pronouncement includes amendments to three standards. The amendments to IFRS 1 'First-time Adoption of International Financial Reporting Standards' and IAS 28 'Investments in Associates and Joint Ventures' have been applied by the group effective 1 January 2018. The amendments to IFRS 12 'Disclosure of Interests in Other Entities' were applied by the group effective 1 January 2017.

(c) Refer to Note 2A3.1 for further information.

(d) Refer to Note 2A3.2 for further information.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

2 BASIS OF PREPARATION *continued*

B. ACCOUNTING STANDARDS *continued*

B1. IMPACT OF NEW IFRS *continued*

The following new standards and amendments to standards have been issued by the International Accounting Standards Board ("IASB") but have an effective date after the date of these financial statements or have not been endorsed by the EU, thus have not been implemented by the group:

Standard	Notes	IASB effective date (for periods commencing on or after)	Planned date of application by the group
• IFRS 16 'Leases'	(e)	1 January 2019	1 January 2019
• IFRIC 23 'Uncertainty over Income Tax Treatments'	(f)	1 January 2019	1 January 2019
• Amendments to IFRS 9 'Financial Instruments: Prepayment Features with Negative Compensation'	(f)	1 January 2019	1 January 2019
• Amendments to IAS 28 'Investments in Associates and Joint Ventures: Long-term Interests in Associates and Joint Ventures'	(f)	1 January 2019	1 January 2019
• Annual Improvements to IFRS Standards 2015-2017 Cycle	(f)	1 January 2019	1 January 2019
• Amendments to IAS 19 'Employee Benefits: Plan Amendment, Curtailment or Settlement'	(f)	1 January 2019	1 January 2019
• Amendments to References to the Conceptual Framework in IFRS Standards	(f), (g)	1 January 2020	1 January 2020
• Amendments to IFRS 3 'Business Combinations'	(f), (g)	1 January 2020	1 January 2020
• Amendments to IAS 1 'Presentation of Financial Statements' and IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors: Definition of Material'	(f), (g)	1 January 2020	1 January 2020
• IFRS 17 'Insurance Contracts'	(f), (g)	1 January 2021	1 January 2021
• IFRS 14 'Regulatory Deferral Accounts'	(f), (g), (h)	1 January 2016	To be decided
• Amendments to IFRS 10 'Consolidated Financial Statements' and IAS 28 'Investments in Associates and Joint Ventures': 'Sale or Contribution of Assets between an Investor and its Associate or Joint Venture'	(f), (g), (i)	Deferred indefinitely	To be decided

(e) Details of the impact of implementing IFRS 16 'Leases' is described at Note 2B2 overleaf.

(f) The future application of this pronouncement is not expected to have a material impact on the group's accounting policies, financial position or performance.

(g) This pronouncement has not yet been endorsed by the EU.

(h) The endorsement process of this interim standard has not been launched as the EU has decided to wait for the final standard to be issued.

(i) The IASB set the effective date of this pronouncement as for periods commencing on or after 1 January 2016. However, in December 2015, the IASB postponed the effective date indefinitely pending the outcome of its research project on the equity method of accounting. The EU endorsement process for this pronouncement has been postponed, awaiting a revised exposure draft from the IASB. The effective date will be amended in due course.

The ECO scheme was established on 4 December 2012 by The Electricity and Gas (Energy Company Obligation) Order 2012 ("the Order"). It imposes a legal obligation on larger energy suppliers to deliver energy efficiency measures to domestic energy users.

Once a supplier has been considered eligible for the ECO obligation, based on their domestic customer numbers, the amount of the obligation is established based on the amount of energy supplied to such domestic customers. The overall obligation period is multiannual and the obligation period is broken down into different phases. For each phase, Ofgem determines the amount of each supplier's obligation based on the domestic energy supplied by each energy supplier as a proportion of the total domestic energy supplied by all suppliers during the relevant notification period.

The ECO obligation commenced on 1 January 2013 and was initially expected to run to 31 March 2015. On 5 December 2013 the UK Government announced an extension of the overall obligation period from 31 March 2015 to 31 March 2017. The scheme was subsequently extended further to cover the period from 1 April 2017 to 30 September 2018.

On 3 December 2018, the UK Government approved a new ECO obligation referred to as 'ECO 3'. This will run from December 2018 until 31 March 2022 and focus on low income and vulnerable households, helping to meet the UK Government's fuel poverty commitments.

ScottishPower considers that the appropriate accounting treatment is prescribed by IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' as this obligation complies with the three features to be considered for a provision (present obligation, probable out-flow of resources and a reliable estimate can be made). In accordance with a legal opinion obtained by ScottishPower, it is considered that an obligation arises for each phase of the overall obligation period. For this reason, it is appropriate to consider this obligation as an additional cost of supply to domestic customers, as this activity constitutes the obligating event, as defined under IAS 37.

The FRC staff paper 'Accounting for the Energy Company Obligation', dated 27 September 2013, indicates that the expenditure should be recognised as the assigned measures are being implemented, regardless of the rate at which energy is supplied to the domestic customers. The external auditor has determined that this is the only accounting treatment which is acceptable.

Based on the FRC staff paper and the opinion of the external auditor, the group has recorded the expense in its financial statements as the measures were actually implemented during the year. This accounting treatment involves recording a £16.6 million (2017 £3.4 million) reduction to the amount that would have resulted from following a recognition rate of the obligation consistent with the rate of energy supplied to domestic customers during the accounting period.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

2 BASIS OF PREPARATION *continued*

B. ACCOUNTING STANDARDS *continued*

B2. IMPACT OF FUTURE IMPLEMENTATION OF IFRS 16

IFRS 16 'Leases' is effective for the group and the company as from 1 January 2019. The impact of implementing this standard is detailed below. The impact of this standard will have no effect on the recorded cash flows.

From the lessors' perspective, IFRS 16 does not introduce any significant change.

From the lessees' perspective, IFRS 16 removes the current classification of operating and finance leases and requires, for any lease agreements, that the lessee recognises the present value of the lease on the balance sheet as a right-of-use asset and a liability.

The group and the company has carried out analysis in order to assess whether an agreement is, or contains, a lease at its inception considering the requirements of IFRS 16. In this analysis, in line with the Iberdrola group, the group has concluded that the assignment of land use does not constitute a lease when the landowner has the right to operate any kind of economic activity on the land in order to continue obtaining more than insignificant economic benefits as a result of that use.

Within its ordinary business activities, the group enters into agreements whereby it obtains the right to use land owned by third parties to carry out activities such as the construction, operation and maintenance of renewable energy generation facilities, as well as for the purposes of electricity transmission and distribution. Clauses within these contracts allow the landowner to access the land and continue carrying out economic activities, provided that they do not interfere with the operation of the activities carried out by the group. In line with the Iberdrola group, the group has concluded that such contracts grant shared use of the land to both the owner and the group, thus the group does not have the right to control the use of the underlying asset. Therefore, such agreements do not contain a lease in accordance with IFRS 16.

The group and the company will transition to IFRS 16 applying the modified retrospective method which does not require comparative periods to be restated but recognises the effect of the initial application of IFRS 16 on the date it is implemented i.e. 1 January 2019. Therefore, for lease agreements in which the group is the lessee, the lease liability will be measured at the present value of the remaining lease payments, applying an appropriate discount rate as at the date of initial application. Generally, right-of-use assets will be measured as the same amount as the corresponding liabilities; both these assets and liabilities will be recognised on the balance sheet.

The right-of-use assets will be depreciated and the charge recorded within Depreciation and amortisation charge, allowances and provisions in the consolidated income statement; similarly the discount on the liabilities will unwind over the term of the lease and be charged to Finance costs in the consolidated income statement. The expense in the year relating to minimum lease payments under operating leases will no longer be recognised in the consolidated income statement; a charge of £26.7 million was recognised in 2018 for the group (refer to Note 7(c)).

Based on the scope exemptions available under IFRS 16, in line with the Iberdrola group, the group has opted not to apply it to lease agreements for intangible assets and short-term leases i.e. leases with a term of twelve months or less (which will continue being accounted for as now under IAS 17).

A contract may include multiple lease components, not all of which would qualify as a lease under IFRS 16. In line with the Iberdrola group, the group has opted to not separate multiple components for accounting purposes but will recognise them as a single component, except for certain agreements for which the separation may have a significant impact on the financial statements.

As at 1 January 2019, IFRS 16 will give rise to increases in current and non-current liabilities for the group totalling an estimated £151.5 million and for the company totalling an estimated £118.7 million as noted below for the different types of underlying assets:

Estimated total lease liability as at 1 January 2019	Group £m	Company £m
Buildings	127.3	118.3
Vehicles	11.3	0.2
Land	12.6	–
Other	0.3	0.2
Total	151.5	118.7

The total liabilities noted above is presented on a discounted net present value basis. As at the date of initial application, the range of discount rates used to calculate the above pertaining to Sterling were in the range of between 1.12% and 4.94% for the group and between 1.22% and 3.23% for the company.

In comparing the group's and the company's future minimum lease payments under non-cancellable operating leases under the scope of IAS 17 as at 31 December 2018 (refer to Note 7(c) and 37(b) respectively) to the lease liabilities to be recognised as at 1 January 2019 under IFRS 16 (see analysis above), the main reconciling items relate to scope changes between the two standards; specifically leases relating to wind farms and the application of different discount rate assumptions.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

2 BASIS OF PREPARATION *continued*

B. ACCOUNTING STANDARDS *continued*

B2. IMPACT OF FUTURE IMPLEMENTATION OF IFRS 16 *continued*

Under IAS 17, the majority of lease agreements for land on which wind generation facilities are located, are designated as operating leases. On the initial application of IFRS 16 on 1 January 2019, in line with the Iberdrola group, the group has concluded that the majority of these agreements do not contain a lease in accordance with the criteria of IFRS 16 previously described. This interpretation of the application of IFRS 16 is based on international practice in the scope of the initial application of the IFRS 16.

However, the accounting treatment of agreements permitting the shared use of the underlying asset under IFRS 16 is subject to revision based on future interpretations. The group will follow future discussions on the matter in order to confirm the reasonableness of the proposed accounting treatment.

C. BASIS OF CONSOLIDATION

The consolidated Accounts incorporate the Accounts of the company and its subsidiaries to 31 December each year.

Subsidiaries are those entities which the group has the right to control, generally where a shareholding confers more than half of the voting rights.

On acquisition, the assets and liabilities of a subsidiary are measured at their fair values at the date of acquisition. The cost of an acquisition is measured at the fair value of any assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. If the fair value of the net assets acquired is in excess of the cost of acquisition, the group reassesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed, and reviews the procedures used to measure the amounts to be recognised at the acquisition date. If the reassessment still results in an excess of the fair value of the net assets acquired over the cost of acquisition, then the gain is recognised in profit or loss.

The interest of non-controlling shareholders is initially stated at the non-controlling party's proportion of the fair values of the assets and liabilities recognised. In a business combination achieved in stages, the previously held equity interest in the acquiree is remeasured at its acquisition date fair value and any resulting gain or loss recognised in profit or loss.

In accordance with the exemption permitted by IFRS 1 'First-time Adoption of International Financial Reporting Standards', business combinations accounted for prior to the group's date of transition to IFRS on 1 April 2004 have not been restated to comply with IFRS 3 'Business Combinations'.

The results of subsidiaries acquired or disposed of during the year are included in the income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

For the consolidated group, intra-group transfers of subsidiaries within the Iberdrola group, but outwith the Scottish Power UK plc group, are deemed to be business combinations under common control. These transactions are accounted for using the pooling of interests method. The results for the subsidiaries transferred are included in the income statement from the effective date of acquisition. The net assets incorporated at the date of acquisition reflect the book value of each of the subsidiaries included in the Iberdrola consolidated financial statements, the highest entity that has common control for which consolidated IFRS financial statements are prepared.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

3 JUDGEMENTS, ESTIMATION UNCERTAINTIES AND ACCOUNTING POLICIES

In determining and applying accounting policies, judgement is often required in respect of items where the choice of specific policy to be followed could materially affect the reported amounts of revenues, expenses, assets and liabilities of the group, should it later be determined that a different choice would be more appropriate. The group has no such policies. At 31 December 2018, items which have significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities in the next financial year are detailed below:

- Retail revenue – Note 21(b);
- Impairment losses on trade receivables – Note 3H1.1(b)(iii) and Note 9; and
- Retirement benefit obligation – Note 3L and Note 16.

The principal accounting policies applied in preparing the group's consolidated Accounts and, where applicable, the company's Accounts, are set out below. "The company" refers to Scottish Power UK plc.

- A. REVENUE
- B. PROCUREMENTS
- C. GOODWILL
- D. OTHER INTANGIBLE ASSETS
- E. PROPERTY, PLANT AND EQUIPMENT
- F. LEASED ASSETS
- G. IMPAIRMENT OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS (EXCLUDING GOODWILL)
- H. FINANCIAL INSTRUMENTS
- I. INVENTORIES (EXCLUDING EMISSIONS ALLOWANCES)
- J. EMISSIONS ALLOWANCES AND ROCs
- K. GRANTS AND TRANSFERS OF ASSETS FROM CUSTOMERS
- L. RETIREMENT BENEFITS
- M. DECOMMISSIONING COSTS
- N. FOREIGN CURRENCIES
- O. TAXATION
- P. INVESTMENTS
- Q. CASH AND CASH EQUIVALENTS
- R. DEBT FACTORING
- S. DISCONTINUED OPERATIONS

A. REVENUE

The group has applied IFRS 15 for the first time from 1 January 2018. Information about the group's accounting policies and estimates in relation to contracts with customers is provided in Note 21. The effect of the initial application of IFRS 15 is disclosed in Note 2A3.1.

B. PROCUREMENTS

Procurements principally comprises the cost of electricity and gas purchased during the year in relation to energy supply (and until 31 December 2018, for thermal generation) and related direct costs and services.

C. GOODWILL

Goodwill represents the excess of the fair value of the purchase consideration over the group's share of the fair value of the identifiable assets and liabilities of an acquired subsidiary or business at the date of acquisition.

Goodwill is recognised as an asset and reviewed for impairment at least annually and whenever there is an indication of impairment. Any impairment is recognised in the income statement in the period in which it is identified.

On disposal of a subsidiary, associate, jointly controlled entity or business, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

When a review for impairment is conducted, the recoverable amount is assessed by reference to the net present value of the expected future cash flows of the relevant Cash Generating Unit ("CGU"), or disposal value if higher. The discount rate applied is based on the group's weighted average cost of capital with appropriate adjustments for the risks associated with the CGU. Estimates of cash flows involve a significant degree of judgement and are consistent with management's plans and forecasts.

At 31 December 2018 the carrying value of goodwill amounted to £364.6 million (2017 £364.6 million). Refer to Note 6(b) for further details on the impairment testing performed on goodwill.

D. OTHER INTANGIBLE ASSETS

For both the company and the group, the costs of acquired computer software are capitalised on the basis of the costs incurred to acquire and bring to use the specific software and are amortised on a straight-line basis over their operational lives. Costs directly associated with the development of computer software programmes that are expected to generate economic benefits over a period in excess of one year are capitalised and amortised on a straight-line basis over their estimated operational lives. Costs include employee costs relating to software development and an appropriate proportion of relevant overheads directly attributable to bringing the software into use. Amortisation of computer software costs is over periods of up to eight years.

The group has applied IFRS 15 from 1 January 2018 in relation to customer contract costs. Information about the group's accounting policies and estimates in relation to the customer contract costs is provided in Note 21. The effect of initially applying for IFRS 15 is disclosed in Note 2A3.1.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

3 JUDGEMENTS, ESTIMATION UNCERTAINTIES AND ACCOUNTING POLICIES *continued*

E. PROPERTY, PLANT AND EQUIPMENT

The group's and the company's property, plant and equipment is stated at cost and is generally depreciated on a straight-line basis over the estimated operational lives of the assets. Property, plant and equipment includes capitalised employee costs, interest and other directly attributable costs. Borrowing costs directly attributable to the acquisition, construction or production of major qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. Reviews of the estimated remaining lives and residual values of property, plant and equipment are undertaken annually. Residual values are assessed based on prices prevailing at each balance sheet date.

Land is not depreciated. The main depreciation periods used by the group are as set out below:

	Years
Hydro-electric plants	4-105
Combined Cycle Gas Turbines	2-40
Gas storage facilities	10-35
Wind farms	24-40
Transmission facilities	40
Distribution facilities	24-40
Meters and measuring devices	6-10
Other facilities and other items of property, plant and equipment	2-50

F. LEASED ASSETS

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at inception date; whether fulfilment of the arrangement is dependent on the use of a specific asset(s) or the arrangement conveys a right to use the asset(s), even if that right is not explicitly specified in the arrangement. For arrangements entered into prior to 1 April 2004, the date of inception is deemed to be 1 April 2004 in accordance with the transitional requirements of IFRIC 4 'Determining Whether an Arrangement Contains a Lease'.

The group and the company classify leases as finance leases whenever the lessor transfers substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Finance lease receivables are initially recognised at the lower of the fair value of the leased asset and the present value of future payments. Finance income is subsequently recognised over the useful life of the leased asset using the effective interest method.

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

G. IMPAIRMENT OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS (EXCLUDING GOODWILL)

At each balance sheet date, the group and the company review the carrying amount of its property, plant and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the CGU to which the asset belongs.

H. FINANCIAL INSTRUMENTS

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. The accounting policies below are applicable to both the group's consolidated Accounts and the company's individual Accounts.

H1. ACCOUNTING POLICIES UNDER IFRS 9

H1.1. FINANCIAL ASSETS

(a) Recognition and initial measurement

Financial assets are classified, at initial recognition, as subsequently measured at amortised cost, fair value through other comprehensive income ("FVOCI") or fair value through profit or loss ("FVTPL"). This categorisation determines whether and where any restatement for fair value is recognised.

Trade receivables are initially recognised when they originate. All other financial assets are initially recognised when the company becomes a party to the contractual provisions of the instrument.

A financial asset (unless it is a trade receivable without a significant financing component) is initially measured at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue. A trade receivable without a significant financing component is initially measured at the transaction price determined under IFRS 15. Other investments are valued at fair value at the balance sheet date except where it is not possible to obtain a fair value for unquoted investments in which case they are valued at cost and assessed for impairment.

(b) Classification and subsequent measurement

(i) Classification

Financial assets are not reclassified subsequent to their initial recognition unless the group changes its business model for managing financial assets in which case all affected financial assets are reclassified on the first day of the first reporting period following the change in the business model. These are expected to be infrequent and no other reclassifications are permitted.

The group's business model for managing financial assets refers to how it manages its financial assets in order to generate cash flows. The business model determines whether cash flows will result from collecting contractual cash flows, selling the financial assets, or both. The business model of the group does not depend on the intentions of management for an individual instrument. Therefore, it is not an instrument-by-instrument classification approach and should be determined from a higher level of aggregation.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

3 JUDGEMENTS, ESTIMATION UNCERTAINTIES AND ACCOUNTING POLICIES *continued*

H FINANCIAL INSTRUMENTS *continued*

H1. ACCOUNTING POLICIES UNDER IFRS 9 *continued*

H1.1 FINANCIAL ASSETS *continued*

(b) Classification and subsequent measurement *continued*

(i) Classification *continued*

A financial asset is measured at amortised cost if it meets both of the following conditions:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. This assessment is referred to as the 'SPPI' test.

A financial asset is measured at FVOCI if it meets both of the following conditions:

- it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI test) on the principal amount outstanding.

Trade receivables that do not contain a significant financing component and for which the group has applied the simplified ECL model are measured at the transaction price determined under IFRS 15 (refer to Note 21). All other financial assets not classified as measured at amortised cost or FVOCI as described above are measured at FVTPL.

(ii) Subsequent measurement and gains and losses

Financial assets at amortised cost – these assets are subsequently measured at amortised cost using the effective interest method. The amortised cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment losses are recognised in the income statement. Any gain or loss on derecognition is recognised in the group income statement.

The group's financial assets measured at amortised cost include trade receivables, other receivables and loan and interest receivables due from Iberdrola group companies.

Financial assets at FVTPL – these assets (other than derivatives designated as hedging instruments) are subsequently measured at fair value. Net gains and losses, including any interest or dividend income, are recognised in the income statement.

The group has irrevocably decided that equity instruments existing at the time of the initial application of IFRS 9 should be classified as FVTPL. The group's financial assets held at FVTPL therefore include Other investments.

Derecognition

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognised (i.e. removed from the group's consolidated balance sheet) when:

- The rights to receive cash flows from the asset have expired; or
- The group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the group has transferred substantially all the risks and rewards of the asset, or (b) the group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, it evaluates if, and to what extent, it has retained the risks and rewards of ownership. When it has neither transferred nor retained substantially all of the risks and rewards of the asset, nor transferred control of the asset, the group continues to recognise the transferred asset to the extent of its continuing involvement. In that case, the group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the group has retained (refer to Note 3R).

(iii) Impairment of financial assets

Disclosures relating to impairment of financial assets are provided in Note 9.

The group recognises an allowance for ECLs for all debt instruments not held at FVTPL.

The group has adopted the simplified ECL model for its trade receivables and the general ECL model for all other financial assets measured at amortised cost.

In applying the simplified model, loss allowances for trade receivables are always measured at an amount equal to lifetime ECL. The group has segmented its trade receivables between those relating to Energy Retail customer debt area and those within the rest of the group. For each grouping ScottishPower has established a provision matrix that is based on its historical credit loss experience, adjusted for, where possible, forward-looking factors specific to the debtors and the economic environment.

ECLs for all other financial assets are recognised using the general model. The general model works as follows:

- For credit exposures for which there has not been a significant increase in credit risk since initial recognition, ECLs are provided for credit losses that result from default events that are possible within the next twelve months (a twelve month ECL).
- For those credit exposures for which there has been a significant increase in credit risk since initial recognition, a loss allowance is required for credit losses expected over the remaining life of the exposure, irrespective of the timing of the default (a lifetime ECL).

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

3 JUDGEMENTS, ESTIMATION UNCERTAINTIES AND ACCOUNTING POLICIES *continued*

H FINANCIAL INSTRUMENTS *continued*

H1. ACCOUNTING POLICIES UNDER IFRS 9 *continued*

H1.1 FINANCIAL ASSETS *continued*

(b) Classification and subsequent measurement *continued*

(iii) Impairment of financial assets *continued*

As an exception to the general model, if the credit risk of a financial instrument is low at the reporting date, management can measure impairment using twelve month ECL and so it does not have to assess whether a significant increase in credit risk has occurred. In order for this operational simplification to apply, the financial instrument has to meet the following requirements:

- it has a low risk of default;
- the borrower is considered, in the short-term, to have a strong capacity to meet its obligations; and
- the lender expects, in the longer term, that adverse changes in economic and business conditions might, but will not necessarily, reduce the ability of the borrower to fulfil its obligations.

All of the group's other financial assets have low credit risk at both the beginning and end of the reporting period.

The group considers these assets to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'. The group considers this to be BBB- or higher per rating agency Standard & Poor's.

For retail debt, the group does not assume that the credit risk on a financial asset has increased significantly if it is more than 30 days past due. Debts for gas and electricity customers on secure payment plans (e.g. Direct Debit), can have debts in excess of 30 days which would not be considered overdue. Direct Debit payments are based on an annual cycle therefore customers can be in either a debt or credit position at certain points in the year.

The group considers a financial asset to be in default when:

- internal or external information indicates that the group is unlikely to receive the outstanding contractual amounts in full before taking into account any credit enhancements held by the group; or
- the financial asset is more than 90 days past due.

Measurement of ECLs

ECLs are a probability-weighted estimate of credit losses.

Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument.

Twelve month ECLs are the portion of ECLs that result from default events that are possible within the twelve months after the reporting date (or a shorter period if the expected life of the instrument is less than twelve months).

The maximum period considered when estimating ECLs is the maximum contractual period over which the company is exposed to credit risk.

Credit losses are measured as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the company expects to receive). ECLs are discounted at the effective interest rate of the financial asset.

Credit-impaired financial assets

At each reporting date, the company assesses whether financial assets carried at amortised cost are credit-impaired. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Write-offs

The gross carrying amount of a financial asset is written off (either partially or in full) to the extent that there is no realistic prospect of recovery.

H1.2 FINANCIAL LIABILITIES

(a) Recognition and initial measurement

The group's financial liabilities include trade and other payables, loans and borrowings, and derivative financial instruments.

All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings and payables, net of directly attributable transaction costs.

(b) Classification and measurement

Financial liabilities are classified as measured at FVTPL or amortised cost.

A financial liability is classified as FVTPL if it is classified as held-for-trading, it is a derivative or it is designated as such on initial recognition. Financial liabilities at FVTPL are measured at fair value and net gains and losses, including any interest expense, are recognised in the income statement.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method. Interest expense and foreign exchange gains and losses are recognised in the income statement. Any gain or loss on derecognition is also recognised in the income statement. This is the category most relevant to the group as it includes, interest-bearing loans and borrowings and trade and other payables.

Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate. The effective interest method is included as Finance costs in the income statement. This subsequent measurement technique does not apply where the loan or borrowing is a hedged item in an effective fair value hedging relationship (refer to Note 3H1.3).

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

3 JUDGEMENTS, ESTIMATION UNCERTAINTIES AND ACCOUNTING POLICIES *continued*

H FINANCIAL INSTRUMENTS *continued*

H1 ACCOUNTING POLICIES UNDER IFRS 9 *continued*

H1.2 FINANCIAL LIABILITIES *continued*

(b) Classification and measurement *continued*

Derecognition

The group derecognises a financial liability when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the income statement.

H1.3 DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING

(a) Derivative financial instruments

The group uses derivative financial instruments, such as forward foreign currency contracts, interest rate swaps and forward commodity contracts, to hedge its foreign currency risks, interest rate risks and commodity price risks. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative.

The gain or loss on remeasurement to fair value is recognised immediately in the income statement. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged.

At the inception of a hedge relationship, the group formally designates and documents the hedge relationship to which it wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge.

Under IFRS 9 the hedge documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the group will assess whether the hedging relationship meets the hedge effectiveness requirements (including the analysis of sources of hedge ineffectiveness and how the hedge ratio is determined). A hedging relationship qualifies for hedge accounting if it meets all of the following effectiveness requirements:

- There is 'an economic relationship' between the hedged item and the hedging instrument.
- The effect of credit risk does not 'dominate the value changes' that result from that economic relationship.
- The hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the group actually hedges and the quantity of the hedging instrument that the group actually uses to hedge that quantity of hedged item.

Hedge accounting is applied when certain conditions required by IFRS 9 are met. The accounting for cash flow hedges and fair value hedges are discussed at (b) and (c) below.

(b) Cash flow hedges

The group designates only the spot element of treasury related forward foreign currency contracts (hedging the value of currency denominated intercompany loans) as a hedging instrument. Since the application of IFRS 9 the forward element is now recognised in Other comprehensive income and accumulated in a separate component of the hedge reserve under the cost of hedging reserve.

For all other forward contracts the group designates all of the forward contract (spot and forward element) as the hedging instrument.

The portion of gain or loss of the hedging instrument that was determined to be an effective hedge is recognised directly in equity and forms part of the hedge reserve. The ineffective portion of the change in fair value of the hedging instruments is recognised in the income statement within Procurements for hedges of underlying operations. For hedges of financing activities, any ineffectiveness is recognised within Finance income or Finance costs, as appropriate, in the income statement. If the cash flow hedge relates to an underlying transaction which results in the recognition of a non-financial asset, the associated gains or losses on the derivative that had previously been recognised in equity are recognised in the initial measurement of the asset arising from the hedged transaction. For hedges that relate to an underlying transaction which results in recognition of a financial asset or a liability, amounts deferred in equity are recognised in the income statement in the same period in which the hedged item affects the income statement.

The group discontinues hedge accounting when the hedge instrument expires or is sold, terminated or exercised, when the hedge relationship no longer qualifies for hedge accounting or when the designation is revoked. In the case of cash flow hedging, any gain or loss that has been recognised in equity until that time remains separately recognised in equity until the forecast transaction occurs. If the transaction is no longer expected to occur, related cumulative gains and losses which have been previously deferred in equity are recognised in the income statement.

(c) Fair value hedges

The gain or loss from remeasuring the hedging instrument at fair value is recognised directly in the income statement in the same location as the gain or loss from remeasuring the hedged item. The gain or loss on the hedged item adjusts the carrying amount of the hedged item (when the item would otherwise have been measured at amortised cost) and is recognised in the income statement. The group starts amortisation of any such adjustments to the carrying value of the hedged item when the hedging relationship ends.

On the discontinuance of hedge accounting, any adjustment made to the carrying amount of the hedged item as a consequence of the fair value hedge relationship, is recognised in the income statement over the remaining life of the hedged item.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

3 JUDGEMENTS, ESTIMATION UNCERTAINTIES AND ACCOUNTING POLICIES *continued*

H FINANCIAL INSTRUMENTS *continued*

H1 ACCOUNTING POLICIES UNDER IFRS 9 *continued*

H1.3 DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING *continued*

(d) Valuation of financial instruments

In those circumstances where IFRS 9 requires financial instruments to be recognised in the balance sheet at fair value, the group's valuation strategies for derivative and other financial instruments utilise as far as possible quoted prices in an active trading market.

In the absence of quoted prices for identical or similar assets or liabilities, it is sometimes necessary to apply valuation techniques where contracts are marked using approved models. Models are used for developing both the forward curves and the valuation metrics of the instruments themselves where the instruments are complex combinations of standard or non-standard products. All models are subject to rigorous testing prior to being approved for valuation, and subsequent continuous testing and approval procedures are designed to ensure the validity and accuracy of the model assumptions and inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, the details of which are described in Note 9.

(e) Offsetting of financial assets and financial liabilities

The group offsets a financial asset and a financial liability and reports the net amount only when the group has a legally enforceable right to set off the amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

H2. ACCOUNTING POLICIES UNDER IAS 39

As detailed in Note 2A3.2 on application of IFRS 9, the group has elected not to restate comparative information. The accounting policies for the group under IAS 39 have therefore been presented below.

- (a) Financial assets categorised as trade and other receivables are recognised and carried at original invoice amount less a provision for impairment of doubtful debts. Allowance for doubtful debts has been estimated by management, taking into account expected future cash flows, based on past experience, ageing analysis and an assessment of the current economic environment within which the group operates. Such estimates involve a significant degree of judgement.

The provision for impairment of trade receivables at 31 December 2018 amounted to £129.4 million (2017 £126.8 million) and trade receivables and accrued income (net of the provision for impairment) amounted to £924.6 million (2017 £846.5 million).
- (b) The carrying amount of finance lease receivables is calculated as set out in Note 3F.
- (c) Cash and short-term deposits in the balance sheet comprise cash on hand and term deposits which are readily convertible into a known amount of cash without a significant risk of changes in value. In the cash flow statement, cash and cash equivalents exclude term deposits which have a maturity of more than 90 days at the date of acquisition and include bank overdrafts repayable on demand the next business day and the net of current loans receivable and payable from group companies.
- (d) Financial liabilities categorised as trade and other payables are recognised and carried at original invoice amount.
- (e) All interest bearing loans and borrowings are initially recognised at fair value, net of directly attributable transaction costs. Interest bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method, except where the loan or borrowing is a hedged item in an effective fair value hedging relationship (see H2.2 below).
- (f) Other investments are valued at fair value at the balance sheet date except where it is not possible to obtain a fair value for unquoted investments. Revaluation surpluses and deficits are recognised in the statement of comprehensive income.
- (g) The group enters into sale and purchase transactions for gas, electricity and oil in the normal course of its energy business. Most of these contracts are entered into for the purposes of the group's expected business requirements. These 'own use' contracts are outside the scope of IAS 39 and are accounted for on an accruals basis.

Certain physical commodity purchase and sale contracts are within the scope of IAS 39 because they are net settled or are capable of net settlement. All such contracts are classified as derivative financial instruments in accordance with IAS 39. ScottishPower also enters into treasury-related derivatives to manage its financial risk. The group's policies and management with respect to risks are discussed in Note 9(e).

IAS 39 requires all derivatives to be recognised on the balance sheet at fair value. Embedded derivatives in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not carried at fair value through the income statement.

Unrealised gains or losses on remeasurement of derivatives and embedded derivatives are reported in the income statement except when hedge accounting is applied (see H2.2 below). Fair value gains and losses on derivatives used in the group's energy management activities are recognised in the income statement within Procurements and fair value gains and losses on derivatives used in the group's treasury activities are recognised in the income statement as Finance income or Finance costs as appropriate.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

3 JUDGEMENTS, ESTIMATION UNCERTAINTIES AND ACCOUNTING POLICIES *continued*

H. FINANCIAL INSTRUMENTS *continued*

H2 ACCOUNTING POLICIES UNDER IAS 39 *continued*

H2.1 RISK CONTROL ENVIRONMENT

The group's strategy is to conduct business in a manner benefiting customers through balancing cost and risk while delivering shareholder value and protecting the group's performance and reputation by prudently managing the risks inherent in the business. To maintain this strategic direction the group develops and implements risk management policies and procedures, and promotes a rigid control environment at all levels of the organisation. Further details of the group's strategy and management of risks are discussed in detail in Note 9(e).

H2.2 HEDGE ACCOUNTING

Hedge accounting is applied when certain conditions required by IAS 39 are met. The categories of hedge accounting are consistent with those of IFRS 9.

H2.3 CASH FLOW HEDGES

With the exception of the accounting treatment of the forward element of treasury related forward exchange contracts (discussed in Note 3H1.3(b)), accounting for cash flow hedges is consistent with the IFRS 9 treatment.

H2.4 FAIR VALUE HEDGES

Accounting treatment of fair value hedges is consistent with IFRS 9.

H2.5 DISCONTINUING HEDGE ACCOUNTING

Both the circumstances that cause hedge accounting to be discontinued and the accounting treatment of such hedges are consistent with IFRS 9.

H2.6 VALUATION OF FINANCIAL INSTRUMENTS HELD AT FAIR VALUE

Valuation of financial instruments held at fair value is consistent with IFRS 9.

H3. OFFSETTING OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

This is consistent with the policy under IFRS 9.

I. INVENTORIES (EXCLUDING EMISSIONS ALLOWANCES AND ROCs)

Inventories are valued at the lower of cost and net realisable value. Cost includes all directly attributable costs incurred in bringing the inventories to their present location and condition.

J. EMISSIONS ALLOWANCES AND ROCs

The group participates in the EU ETS and the Renewables Obligation ("RO") scheme administered by Ofgem. As there are no specific rules under IFRS dealing with the treatment of emissions allowances or ROCs, the group, in alignment with Iberdrola group accounting policy, classifies purchased emissions allowances and ROCs as inventories as they are consumed in the production process. Such allowances and certificates are recognised at their acquisition cost and are charged to the income statement as the obligations arise. Internally generated ROCs are awarded by Ofgem and are recognised at their relevant buyout price and estimated recycle price at the balance sheet date.

The group recognises liabilities in respect of its obligations to deliver both schemes at the value at which these allowances and certificates were initially recorded on the balance sheet. Any estimated shortfall in the liabilities are calculated based on the market price of the allowances and relevant buyout price and estimated recycle price at the balance sheet date respectively.

K. GRANTS AND TRANSFERS OF ASSETS FROM CUSTOMERS

Capital and revenue grants and transfers of assets from customers are initially credited to Deferred income.

Capital grants are released to the income statement in equal instalments over the estimated operational lives of the related assets. Revenue grants are released to the income statement over the period in which they are intended to contribute to expenditure incurred.

Pursuant to the applicable industry regulations, the group occasionally receives contributions from its customers for the construction of grid connection facilities, or is assigned such assets that must be used to connect those customers to a network and provide them with ongoing access to a supply of goods or services, or both. As the installation received is considered to be payment for ongoing access to the supply of the goods and services, it is credited to deferred income and released to the income statement in equal instalments over the estimated operational lives of the related assets.

L. RETIREMENT BENEFITS

The group provides pensions through two defined benefit schemes and one defined contribution retirement benefit scheme in the UK.

The cost of providing benefits under the defined benefit schemes is determined using the projected unit credit method, with actuarial valuations being carried out at each balance sheet date. Remeasurements of the net defined benefit liability are recognised, directly in retained earnings, in the period in which they occur and are shown in the statement of comprehensive income. The current service cost element of the pension charge is recognised within Staff costs in the consolidated income statement. Net interest on the net defined benefit liability or asset is included within Finance costs and Finance income, respectively, in the consolidated income statement. The retirement benefits asset and liability recognised in the balance sheet represent the net surpluses and deficits respectively in the group's defined benefit pension schemes.

Payments to the defined contribution scheme are charged as an expense as they fall due.

The expense and balance sheet items relating to the group's accounting for pension schemes under IAS 19 are based on actuarial valuations.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

3 JUDGEMENTS, ESTIMATION UNCERTAINTIES AND ACCOUNTING POLICIES *continued*

L. RETIREMENT BENEFITS *continued*

Inherent in these valuations are key assumptions, including discount rates, earnings increases, increases in pension payments and mortality. These actuarial assumptions are reviewed annually in line with the requirements of IAS 19. The assumptions adopted are based on prior experience, market conditions and the advice of actuaries and other specialists within the Iberdrola group.

At 31 December 2018, the liability in the balance sheet for retirement obligations amounted to £512.7 million (2017 £564.8 million). Sensitivity disclosures relating to ScottishPower's retirement benefit obligations are set out in Note 16.

M. DECOMMISSIONING COSTS

Provision is made on a discounted basis for the estimated decommissioning costs at the end of the producing lives of the group's generating facilities. Capitalised decommissioning costs are depreciated over the useful lives of the related assets. The unwinding of the discount is included within Finance costs.

N. FOREIGN CURRENCIES

Transactions in foreign currencies are translated at the spot rate at the date of the transaction. At the year end, monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange ruling at the balance sheet date, with exchange gains and losses recognised in the consolidated income statement.

The results and cash flows of overseas subsidiaries are translated to Sterling at average rates of exchange. The net assets of any such subsidiaries, including fair value adjustments and the goodwill arising on their acquisition, are translated to Sterling at the closing rates of exchange ruling at the balance sheet date.

O. TAXATION

The group's and the company's assets and liabilities for current tax are calculated using the tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on the difference between the carrying amounts of assets and liabilities in the balance sheet and the corresponding tax bases used in the computation of taxable profits (temporary differences), and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that taxable profit will be available against which deductible temporary differences, unused tax losses or credits can be utilised.

Deferred tax is calculated on a non-discounted basis at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised based on tax rates and laws enacted or substantively enacted at the balance sheet date. Deferred tax is charged to the income statement, except where it relates to items charged or credited to equity (via the statement of comprehensive income), in which case the deferred tax is also dealt with in equity and is shown in the statement of comprehensive income.

P. INVESTMENTS

The company's investments in subsidiaries are stated in the balance sheet at cost, or fair value of shares issued as consideration where applicable. Dividends from subsidiaries are recognised when the right to receive the dividend is established.

Q. CASH AND CASH EQUIVALENTS

Cash and short-term deposits in the balance sheet comprise cash on hand and term deposits which are readily convertible into a known amount of cash without significant risk of changes in value. In the cash flow statement, cash and cash equivalents exclude term deposits which have a maturity of more than 90 days at the date of acquisition and include bank overdrafts repayable on demand the next business day.

R. DEBT FACTORING

On occasion, the group will sell certain of its receivables (at a discount) in exchange for rights to cash collected from those receivables. Where this transfers the contractual rights to receive the cash flows of the receivable, the financial asset will be derecognised when substantially all of the risks and rewards of the receivable have been transferred.

S. DISCONTINUED OPERATIONS

A discontinued operation is a component of the group's business, the operations and cash flows of which can be clearly distinguished from the rest of the group and which represents a separate major line of business or geographical area of operations; is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or is a subsidiary acquired exclusively with a view to resale.

Classification as a discontinued operation occurs at the earlier of disposal or when the operation meets the criteria to be classified as held-for-sale. When an operation is classified as a discontinued operation, the comparative consolidated income statement and consolidated statement of comprehensive income are restated as if the operation had been discontinued from the start of the comparative year.

Refer to Note 28 for details of the group's discontinued operations.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

4 BUSINESS SEGMENT REPORTING

(a) Operating segments and business divisions

The group classifies its operating segments based on a combination of factors, principally differences in products and services and the regulatory environment in which each business operates. The group is organised into three reportable segments; Energy Networks, Renewables and Energy Wholesale and Retail. The group identifies SPT, SPD and SPM as individual operating segments, but as management deem these operating segments to exhibit similar economic characteristics, they have been aggregated (together with other Energy Networks entities) into a single reported segment, Energy Networks. In line with IFRS 8 the group reports its segments on this basis and the measure of profit used for the purpose of reporting to the Chief Operating Decision maker ("CODM") is operating profit as per the consolidated income statement. All revenue for the reported segments arise from operations within Great Britain and Ireland. Revenue arising from operations within the Republic of Ireland is not deemed material enough to disclose as a separate operating segment.

In accordance with the disclosure requirements of IFRS 8, the Annual Report and Accounts of the group reports the relevant financial results of the reported segments as described above. In the interest of improved transparency, the group has voluntarily disclosed revenue and operating profit for the year ended 31 December 2018 for the separate business divisions within the Renewables and Energy Wholesale and Retail reported segments, whilst also providing detail in relation to non-recurring items and certain remeasurements arising from IFRS 9 (IAS 39 in 2017), consistent with the Supply and Generation regulatory licence conditions. This information has been calculated, where appropriate, in accordance with Standard Licence Condition 16B of the Electricity Generation Licence and Standard Condition 19A of the Electricity and Gas Supply Licences.

During the year ended 31 December 2018, the group's reported segments and business divisions were as follows:

Reported segment	Status of operations	Business division	Business division description
Energy Networks	Continuing	Energy Networks	The transmission and distribution business within the group.
Renewables	Continuing	Renewables – Licensed business ¹	The Great Britain licensed activity of the Renewables reported segment, which develops and operates renewable generation plant, other than hydro-electric generation plant.
		Other	The non-licensed activity of the Renewables reported segment, which includes generation activity outside Great Britain and the impact of the amortisation of fair value attributed to the Renewables operating segment when purchased by Iberdrola during 2007.
Energy Wholesale and Retail	Continuing	Supply – Licensed business ¹	The licensed continuing activity of the Energy Wholesale and Retail reported segment responsible for the supply of electricity and gas to domestic and non-domestic customers.
		Energy Management ¹	The non-licensed continuing activities of the Energy Wholesale and Retail reported segment, responsible for wholesale market purchases for the Supply – Licensed business division, and up to 31 December 2018, for wholesale market sales and purchases for the Thermal and Hydro-electric – Licensed business division.
		Other	The non-licensed continuing activity of the Energy Wholesale and Retail reported segment which includes the group's Energy Services activities and non-licensed metering activities, including smart meter asset provision.
	Discontinued	Thermal and Hydro-electric – Licensed business ¹	The licensed discontinued activity of the Energy Wholesale and Retail reported, segment which owned and operated gas and hydro-electric generation plant.
		Other	The non-licensed discontinued activity of the Energy Wholesale and Retail reported segment which included the results of the group's waste water treatment facility.

¹ Renewables – Licensed, Supply – Licensed, Energy Management and Thermal and Hydro-electric – Licensed businesses are consistent with those disclosed in the Consolidated Segmental Statements for the Supply and Generation licensed businesses presented in accordance with Standard Licence Condition 16B of the Electricity Generation Licence and Standard Condition 19A of the Electricity and Gas Supply Licences. These statements can be found at: www.scottishpower.com/pages/company_reporting.aspx.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

4 BUSINESS SEGMENT REPORTING *continued*

(b) Revenue by reported segment and business division for continuing operations

(i) Revenue by reported segment for continuing operations

The revenue by reported segment for continuing operations for the year ended 31 December 2018 is detailed below.

Reported segment	External revenue £m	Inter-segment revenue £m	Revenue reported to the CODM £m
Energy Networks	1,024.2	143.2*	1,167.4
Renewables	56.2	484.1	540.3
Energy Wholesale and Retail	3,913.3	6.6	3,919.9
Elimination of inter-segment revenue			(633.9)
			4,993.7

* Inter-segment revenue relating to Energy Networks is predominantly subject to regulation and is based on published tariffs set by Ofgem.

The revenue by reported segment for continuing operations for the year ended 31 December 2017 is detailed below.

Reported segment	External revenue** £m	Inter-segment revenue £m	Revenue reported to the CODM** £m
Energy Networks	955.9	150.4*	1,106.3
Renewables	52.6	420.6	473.2
Energy Wholesale and Retail	3,872.8	6.9	3,879.7
Elimination of inter-segment revenue			(577.9)
			4,881.3

* Inter-segment revenue relating to Energy Networks is predominantly subject to regulation and is based on published tariffs set by Ofgem.

** Comparative figures have been restated (refer to Notes 2 and 28).

(ii) Additional information – Revenue by reported segment and business division for continuing operations

The revenue by reported segment and business division for continuing operations for the year ended 31 December 2018 is detailed below. No comparative information has been provided as this is a voluntary disclosure as described on page 51.

Reported segment	Business division	Revenue £m	Joint venture share of revenue (Note (iii)) £m	Revenue re-allocations as per regulatory licence requirements (Note (iv)) £m	Revenue as per regulatory licence requirements £m
Energy Networks		1,167.4	–	–	1,167.4
	Renewables – Licensed business	525.0	8.5	–	533.5
	Other	15.3	1.0	–	16.3
Renewables		540.3	9.5	–	549.8
	Supply – Licensed business	3,865.9	–	(28.1)	3,837.8
	Energy Management	4,837.3	–	–	4,837.3
	Other	62.3	–	–	62.3
	Elimination of intra-segment revenue*	(2,269.9)	–	–	(2,269.9)
	Netting adjustment	(2,575.7)	–	–	(2,575.7)
Energy Wholesale and Retail		3,919.9	–	(28.1)	3,891.8
Elimination of inter-segment revenue		(633.9)	–	–	(633.9)
Total		4,993.7	9.5	(28.1)	4,975.1

* Inter-segment revenue includes adjustments to reflect the continuance of certain transactions following the disposal of the Generation group (refer to Note 28).

(iii) Joint venture share of revenue for continuing operations

All joint ventures within the group are consolidated using the equity method. The results of the joint ventures are therefore presented within Results of companies accounted for using the equity method on the face of the consolidated income statement and so do not form part of Revenue.

As per the licence conditions, and the associated regulatory reporting, the group is required to proportionally consolidate the results of the joint ventures and so present revenues and costs in the appropriate lines of the income statement.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2017

4 BUSINESS SEGMENT REPORTING *continued*

(b) Revenue by reported segment and business division for continuing operations *continued*

(iv) Revenue re-allocations as per regulatory licence requirements for continuing operations

As disclosed in Note 23 of the financial statements, in line with group accounting policy, Taxes other than income tax includes the costs of the WHD scheme. As per the licence conditions, these costs are required to be deducted from Revenue.

(c) Operating profit/(loss) by reported segment and business division for continuing operations

(i) Operating profit/(loss) by reported segment for continuing operations

The operating profit/(loss) by reported segment for continuing operations for the year ended 31 December 2018 is detailed below.

Reported segment	Operating profit/(loss) reported to the CODM* £m
Energy Networks	545.9
Renewables	271.7
Energy Wholesale and Retail	124.8
Unallocated	(0.6)
Total	941.8

The operating profit/(loss) by reported segment for continuing operations for the year ended 31 December 2017 is detailed below.

Reported segment	Operating profit/(loss) reported to the CODM* £m
Energy Networks	538.9
Renewables	190.5
Energy Wholesale and Retail	(62.5)
Unallocated	(14.3)
Total	652.6

* Comparative figures have been restated to reflect continuing operations only (refer to Note 28).

(ii) Additional information – Operating profit/(loss) by reported segment and business division for continuing operations

The operating profit by reported segment and business division for continuing operations for the year ended 31 December 2018 is detailed below. No comparative information has been provided as this is a voluntary disclosure as described on page 51.

Reported segment	Business division	Operating profit/(loss) £m	Joint venture share of operating profit (Note (iii)) £m	Non-recurring items (Note (iv)) £m	Certain remeasurements (Note (v)) £m	Adjusted operating profit as per regulatory licence requirements £m
Energy Networks		545.9	–	(1.5)	–	544.4
	Renewables – Licensed business	286.9	1.6	(29.0)	–	259.5
	Other	(15.2)	0.4	(0.6)	–	(15.4)
Renewables		271.7	2.0	(29.6)	–	244.1
	Supply – Licensed business	142.3	–	(19.3)	–	123.0
	Energy Management	(15.1)	–	15.0	(11.5)	(11.6)
	Other	(2.4)	–	(5.4)	–	(7.8)
Energy Wholesale and Retail		124.8	–	(9.7)	(11.5)	103.6
Unallocated		(0.6)	–	2.5	–	1.9
Total		941.8	2.0	(38.3)	(11.5)	894.0

(iii) Joint venture share of operating profit for continuing operations

All joint ventures within the group are consolidated using the equity method. The results of the joint ventures are therefore presented within Results of companies accounted for using the equity method on the face of the consolidated income statement and so do not form part of Operating profit.

As per the licence conditions, and the associated regulatory reporting, the group is required to proportionally consolidate the results of the joint ventures and so presents revenues and costs in the appropriate lines of the income statement.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

4 BUSINESS SEGMENT REPORTING *continued*

(c) Operating profit/(loss) by reported segment and business division for continuing operations *continued*

(iv) Non-recurring items for continuing operations

In the year ended 31 December 2018 the following non-recurring items were recorded:

Provisions for restructuring and other liabilities: On review of the group's provisions as at 31 December 2018, net restructuring provisions and associated pension costs of £1.0 million were recognised principally in relation to a group-wide restructuring programme.

Impairment and non-current asset write-offs: During the year ended 31 December 2018 the group recognised an impairment charge of £5.6 million which comprised write-offs of gas storage assets of £3.2 million, operational wind farm assets of £1.2 million and other assets of £1.2 million. Non-current asset write-offs of £0.8 million were also recognised.

Non-recurring costs/income: During the year ended 31 December 2018 the group recognised £10.1 million of non-recurring costs and £55.8 million of non-recurring income, principally on the settlement of various contractual disputes.

(v) Certain remeasurements for continuing operations

Certain remeasurements are the fair value movements on energy contracts arising from the application of IFRS 9 (IAS 39 in 2017). These have been disclosed separately to aid the understanding of the underlying performance of the group.

(d) Other financial data by reported segment for continuing operations

Other items by reported segment for the year ended 31 December 2018	Acquisition of property, plant and equipment and intangible assets reported to the CODM £m	Depreciation, amortisation and impairment reported to the CODM £m	Expected credit loss on trade and other receivables reported to the CODM £m
Energy Networks	594.3	283.3	0.8
Renewables	346.3	132.3	–
Energy Wholesale and Retail	165.4	76.3	58.6
Unallocated	26.8	19.3	0.1
Total	1,132.8	511.2	59.5

Other items by reported segment for the year ended 31 December 2017	Acquisition of property, plant and equipment and intangible assets reported to the CODM* £m	Depreciation, amortisation and impairment reported to the CODM* £m	Impairment of trade and other receivables reported to the CODM £m
Energy Networks	732.6	249.8	0.6
Renewables	737.7	125.5	–
Energy Wholesale and Retail	184.3	62.0	67.3
Unallocated	21.9	18.5	0.1
Total	1,676.5	455.8	68.0

* Comparative figures have been restated to reflect continuing operations only (refer to Note 28).

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

4 BUSINESS SEGMENT REPORTING *continued*

(e) Revenue and operating profit as per regulatory licence requirements for discontinued operations

The revenue and operating profit for discontinued operations for the year ended 31 December 2018 has been reconciled to the revenue and operating profit as per regulatory licence requirements in the tables below.

	Revenue £m	Non-recurring items (Note (ii)) £m	Certain remeasurements (Note (ii)) £m	Revenue as per regulatory licence requirements £m
Thermal and Hydro-electric – Licensed business	526.5	–	–	526.5
Elimination of intra-segment revenue	(1.8)	–	–	(1.8)
Total discontinued operations	524.7	–	–	524.7

	Operating profit £m	Non-recurring items (Note (ii)) £m	Certain remeasurements (Note (ii)) £m	Adjusted operating profit/loss as per regulatory licence requirements £m
Thermal and Hydro-electric – Licensed business	15.2	(1.1)	(0.3)	13.8
Other*	19.9	0.1	–	20.0
Total discontinued operations	35.1	(1.0)	(0.3)	33.8

* Other includes adjustments to reflect the continuance of certain transactions following the disposal of the Generation group (refer to Note 28).

(i) Non-recurring items for discontinued operations

In the year ended 31 December 2018 the following non-recurring items were recorded:

Provisions for restructuring and other liabilities: On review of the group's provisions as at 31 December 2018 £0.4 million was released in relation to net restructuring provisions in relation to a group-wide restructuring programme.

Impairment and non-current asset write-offs: During the year ended 31 December 2018, non-current asset write offs of £0.5 million were recognised.

Non-recurring costs/income: During the year ended 31 December 2018 the group recognised £0.1 million of non-recurring costs and £1.2 million of non-recurring income on the settlement of various contractual disputes.

(ii) Certain remeasurements for discontinued operations

Certain remeasurements are the fair value movements on energy contracts arising from the application of IFRS 9 (IAS 39 in 2017). These have been disclosed separately to aid the understanding of the underlying performance of the group.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

5 GROUP INFORMATION

(a) Subsidiaries and joint ventures

The table below sets out details of the subsidiaries and joint ventures of the group and the company as at 31 December. These are all included in the consolidated Accounts for the group. All entities are indirect holdings unless specified. Shares owned by the group are all ordinary shares.

Name	Principal activities	Registered office and country of incorporation (Note (xvii))	Equity interest	
			2018	2017
Energy Networks				
Subsidiaries				
Scottish Power Energy Networks Holdings Limited	Holding company	(A)	100%	(i) 100%
SP Distribution plc	Ownership and operation of distribution network within the ScottishPower area	(A)	100%	100%
SP Manweb plc	Ownership and operation of distribution network within the Mersey and North Wales area	(B)	100%	100%
SP Network Connections Limited	Design and construction of utility connections	(B)	100%	100%
SP Power Systems Limited	Provision of asset management services	(A)	100%	100%
SP Transmission plc	Ownership and operation of transmission network within the ScottishPower area	(A)	100%	100%
Manweb Services Limited	Operation of a private electricity distribution network	(B)	100%	100%
Joint ventures				
NGET/SPT Upgrades Limited	Development and operation of offshore HVDC West Coast transmission link	(C)	50%	(ii), (iii) 50%
Renewables				
Subsidiaries				
ScottishPower Renewable Energy Limited	Holding company	(D)	100%	(i) 100%
Coldham Windfarm Limited	Operation of an onshore wind farm	(B)	80%	80%
East Anglia One Limited	Development and construction of offshore wind farm	(E)	100%	100%
East Anglia One North Limited	Development of offshore wind farm	(E)	100%	(iv) 100%
East Anglia Three Limited	Development of offshore wind farm	(E)	100%	100%
East Anglia Two Limited	Development of offshore wind farm	(E)	100%	(iv) 100%
ScottishPower Renewables (UK) Limited	Development, construction and operation of wind farms	(F)	100%	100%
ScottishPower Renewables (WODS) Limited	Operation of an offshore wind farm	(D)	100%	100%
ScottishPower Renewables (UK Assets) Limited	Dormant	(D)	100%	(v) –
Iberdrola Renovables France SAS	Holding company	(G)	–	(vi) –
Iberdrola Renovables Offshore Deutschland GmbH	Development and construction of offshore wind farm	(H)	–	(vii), (viii) –
Iberdrola Renovables Deutschland GmbH	Holding company	(H)	–	(vii), (ix) –
Ailes Marines SAS	Development of offshore wind farm	(G)	–	(vi) –
Joint ventures				
CeltPower Limited	Operation of an onshore wind farm	(B)	50%	(ii) 50%
East Anglia Offshore Wind Limited	Commercial operation of offshore meteorological masts	(E)	50%	(ii) 50%
Morecambe Wind Limited	Provision of operational services	(I)	50%	(ii) 50%
Energy Wholesale and Retail				
Subsidiaries				
Scottish Power Generation Holdings Limited	Holding company	(D)	100%	(i), (x) 100%
ScottishPower (DCL) Limited	Holding company	(B)	100%	100%
ScottishPower Energy Management Limited	Wholesale energy management company engaged in purchase and sale of electricity and gas	(D)	100%	100%
ScottishPower Energy Management (Agency) Limited	Agent for energy management activity of ScottishPower Energy Management Limited and Scottish Power UK plc	(D)	100%	100%
ScottishPower Generation Limited	Electricity generation	(D)	–	(xi) 100%
ScottishPower (SCPL) Limited	Holding company	(B)	100%	100%
SMW Limited	Wastewater treatment	(D)	–	(xi) 100%
SP Gas Transportation Cockenzie Limited	Holder of Gas Transporter Licence	(D)	100%	100%
SP Gas Transportation Hatfield Limited	Holder of Gas Transporter Licence	(D)	100%	100%
ScottishPower Energy Retail Limited	Supply of electricity and gas to domestic and business customers	(D)	100%	100%
SP Dataserve Limited	Data collection, data aggregation, meter operation and revenue protection	(D)	100%	100%
SP Smart Meter Assets Limited	Provider of smart meter assets and services	(D)	100%	100%
ScottishPower Generation (Assets) Limited	Asset owning company	(D)	100%	(xii) –
Joint ventures				
ScotAsh Limited	Sales of ash and ash-related cementitious products	(J)	–	(ii), (xiii) –

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

5 GROUP INFORMATION *continued*

(a) Subsidiaries and joint ventures *continued*

		Registered office and country of incorporation (Note (xvii))	Equity Interest		
Name	Principal activities		2018		2017
Other					
Subsidiaries					
ScottishPower Investments Limited	Holding company	(D)	100%	(i)	100%
Dormant subsidiaries in liquidation					
SP Gas Limited	In liquidation	(K)	100%	(xiv)	100%
Dormant subsidiaries now dissolved					
Manweb Nominees Limited	Dissolved	(L)	–	(xv)	100%
Scottish Power UK Holdings Limited	Dissolved	(K)	–	(xv)	100%
Demon Internet Limited	Dissolved	(L)	–	(xv)	100%
Manweb Energy Consultants Limited	Dissolved	(L)	–	(xv)	100%
Manweb Share Scheme Trustees Limited	Dissolved	(L)	–	(xv)	100%

- (i) The investment in this company is a direct holding of Scottish Power UK plc.
- (ii) All joint ventures are accounted for using the equity method.
- (iii) NGET/SPT Upgrades Limited has a non-conterminous year end date of 31 March. This is a contractual obligation as agreed in the joint operating agreement.
- (iv) East Anglia One North Limited and East Anglia Two Limited were incorporated on 21 December 2017 and are direct subsidiaries of ScottishPower Renewables (UK) Limited.
- (v) ScottishPower Renewables (UK Assets) Limited was incorporated on 5 February 2018 and is a direct subsidiary of Scottish Power Renewable Energy Limited.
- (vi) On 1 August 2017, the group sold its entire interest in the issued share capital of Iberdrola Renovables France SAS (refer to Note 34). Iberdrola Renovables France SAS has a 70% equity holding in one subsidiary, Ailes Marines SAS.
- (vii) On 1 August 2017, the group sold its entire interest in the issued share capital of Iberdrola Renovables Deutschland GmbH (refer to Note 34). Iberdrola Renovables Deutschland GmbH wholly owns two subsidiaries: Iberdrola Renovables Offshore Deutschland GmbH and Baltic Eagle GmbH (see footnote (viii) below).
- (viii) On 3 December 2015, Iberdrola Renovables Offshore Deutschland GmbH entered into a joint operation with 50Hertz Offshore GmbH. The agreement is for the joint realisation of the offshore substation being built as part of the Wikinger offshore wind farm project located in Germany. Both parties have joint control of this asset. As noted at footnote (vi) above, the group no longer has an interest in this joint operation.
- (ix) On 21 February 2017, Iberdrola Renovables Deutschland GmbH acquired the entire share capital of Baltic Eagle GmbH. The group no longer has an interest in this entity (see footnote (vi) above).
- (x) Scottish Power Generation Holdings Limited changed its name to Scottish Power Retail Holdings Limited on 1 February 2019.
- (xi) On 31 December 2018, the group sold its entire interest in the issued share capital of ScottishPower Generation Limited. ScottishPower Generation Limited has a wholly owned subsidiary, SMW Limited (refer to Note 28). ScottishPower Generation Limited was renamed post-sale by Drax to Drax Generation Enterprise Limited.
- (xii) ScottishPower Generation (Assets) Limited was incorporated on 15 March 2018 and is a direct subsidiary of Scottish Power Generation Holdings Limited (now renamed Scottish Power Retail Holdings Limited).
- (xiii) On 19 July 2017 the group sold its 50% interest in the share capital of ScotAsh Limited (refer to Note 8).
- (xiv) The investment in SP Gas Limited is held 50% directly by the company and 50% by another company within the group.
- (xv) This company was dissolved during the year ended 31 December 2018.
- (xvi) The registered offices of the subsidiaries and joint ventures are as listed below, along with their countries of incorporation. Where a company's registered office is in England it is registered in England and Wales:
- | | |
|--|---|
| (A) Ochil House, 10 Technology Avenue, Hamilton International Technology Park, Blantyre, G72 0HT, Scotland | (G) 40 Rue de la Boetie, 75008, Paris, France |
| (B) 3 Prenton Way, Prenton, CH43 3ET, England | (H) Charlottenstrasse 63, D-10117, Berlin, Germany |
| (C) 1–3 Strand, London, WC2N 5EH, England | (I) 5 Howick Place, London, SW1P 1WG, England |
| (D) 320 St. Vincent Street, Glasgow, G2 5AD, Scotland | (J) Portland House, Bickenhall Lane, Solihull, Birmingham, B37 7BQ, England |
| (E) 3rd Floor, 1 Tudor Street, London, EC4Y 0AH, England | (K) Johnston Carmichael, 227 West George Street, Glasgow, G2 2ND, Scotland |
| (F) The Soloist, 1 Lanyon Place, Belfast, BT1 3LP, Northern Ireland | (L) Johnston Carmichael, 107–111 Fleet Street, London, EC4A 2AB, England |

For those entities incorporated in Scotland, Northern Ireland and England and Wales, the principal place of business is considered to be the United Kingdom; for all other entities, the country of incorporation is the principal place of business.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

5 GROUP INFORMATION *continued*

(b) Significant judgements and assumptions used to determine the scope of the consolidation

The consolidated financial statements combine the financial statements of Scottish Power UK plc and its subsidiaries. A subsidiary is an entity over which the company has control. The company has control over another entity when it has power over the relevant activities of the investee, for example through voting rights; exposure, or rights to, variable returns from its involvement with the investee; and the ability to affect those returns through its power over the investee.

No significant judgements have been made in applying these principles during the year.

(c) Significant restrictions

As is typical for a group of its size and scope, there are restrictions on the ability of the group to obtain distributions of capital, access the assets or repay the liabilities of members of its group due to the statutory, regulatory and contractual requirements of its subsidiaries and due to the protective rights of non-controlling interests. After consideration of these factors, the resulting significant restrictions have been identified:

SP Distribution plc

SP Distribution plc is a regulated DNO whose activities are governed by a licence granted by Ofgem. For such licenced entities the main drivers facilitating distributions including dividends are holding an investment grade credit rating and complying with several other licence conditions. The total value of distributable reserves is restricted by the requirement to comply with several licence conditions including holding an investment grade credit rating. In addition, standard condition 26 of the distribution licence conditions restricts the disposal of property, plant and equipment.

Value restricted	2018 £m	2017 £m
Distributable reserves	610.9	596.4
Property, plant and equipment	2,829.8	2,729.9

SP Manweb plc

SP Manweb plc is a regulated DNO whose activities are governed by a licence granted by Ofgem. For such licenced entities the main drivers facilitating distributions including dividends are holding an investment grade credit rating and complying with several other licence conditions. The total value of distributable reserves is restricted by the requirement to comply with several licence conditions including holding an investment grade credit rating. In addition, standard condition 26 of the distribution licence conditions restricts the disposal of property, plant and equipment.

Value restricted	2018 £m	2017 £m
Distributable reserves	672.8	711.4
Property, plant and equipment	2,878.4	2,721.4

SP Transmission plc

SP Transmission plc is a regulated electricity transmission entity whose activities are governed by a licence granted by Ofgem. For such licenced entities the main drivers facilitating distributions including dividends are holding an investment grade credit rating and complying with several other licence conditions. The total value of distributable reserves is restricted by the requirement to comply with several licence conditions including holding an investment grade credit rating. In addition, standard condition B3 of the transmission licence conditions restricts the disposal of property, plant and equipment.

Value restricted	2018 £m	2017 £m
Distributable reserves	707.9	677.8
Property, plant and equipment	2,819.1	2,696.2

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

6 INTANGIBLE ASSETS

(a) Movements in intangible assets

Year ended 31 December 2017	Notes	Goodwill (Note (b)) £m	Other intangible assets				Total £m
			Computer software (Notes (i), (ii), (iii)) £m	Licences £m	Other £m	Total £m	
Cost:							
At 1 January 2017		364.6	399.2	9.5	1.5	410.2	774.8
Group restructuring	(iv)	–	–	–	(0.4)	(0.4)	(0.4)
Additions	(v)	–	44.5	–	–	44.5	44.5
Transfers from property, plant and equipment		–	0.5	–	–	0.5	0.5
Disposals		–	(6.3)	–	–	(6.3)	(6.3)
At 31 December 2017		364.6	437.9	9.5	1.1	448.5	813.1
Amortisation:							
At 1 January 2017		–	219.9	3.3	0.6	223.8	223.8
Amortisation for the year		–	59.5	0.3	0.4	60.2	60.2
Transfers from property, plant and equipment		–	0.2	–	–	0.2	0.2
Disposals		–	(6.2)	–	–	(6.2)	(6.2)
At 31 December 2017		–	273.4	3.6	1.0	278.0	278.0
Net book value:							
At 31 December 2017		364.6	164.5	5.9	0.1	170.5	535.1
At 1 January 2017		364.6	179.3	6.2	0.9	186.4	551.0

Year ended 31 December 2018	Notes	Goodwill (Note (b)) £m	Other intangible assets				Total £m
			Computer software (Notes (i), (ii), (iii)) £m	Licences £m	Customer contract costs (Note (vi)) £m	Other £m	
Cost:							
At 1 January 2018		364.6	437.9	9.5	–	1.1	813.1
Adjustments due to IFRS 15		–	–	–	80.2	–	80.2
Adjusted balance at 1 January 2018		364.6	437.9	9.5	80.2	1.1	893.3
Additions	(v)	–	33.5	–	53.2	5.4	92.1
Disposals		–	(8.5)	–	–	–	(8.5)
Disposal of subsidiaries	(vii)	–	(10.6)	–	–	–	(10.6)
At 31 December 2018		364.6	452.3	9.5	133.4	6.5	966.3
Amortisation:							
At 1 January 2018		–	273.4	3.6	–	1.0	278.0
Adjustments due to IFRS 15		–	–	–	30.1	–	30.1
Adjusted balance at 1 January 2018		–	273.4	3.6	30.1	1.0	308.1
Amortisation for the year		–	38.5	0.3	25.5	0.9	65.2
Disposals		–	(7.9)	–	–	–	(7.9)
Disposal of subsidiaries	(vii)	–	(10.1)	–	–	–	(10.1)
At 31 December 2018		–	293.9	3.9	55.6	1.9	355.3
Net book value:							
At 31 December 2018		364.6	158.4	5.6	77.8	4.6	611.0
Adjusted balance at 1 January 2018		364.6	164.5	5.9	50.1	0.1	585.2

- (i) The cost of fully amortised computer software still in use at 31 December 2018 was £61.3 million (2017 £30.6 million).
- (ii) Following a review, the group increased the useful life of its customer relationship management system in 2018 (refer to Note 2).
- (iii) Included in computer software is £50.5 million (2017 £57.0 million) relating to the customer relationship management system and £50.5 million (2017 £43.4 million) relating to system upgrades for smart metering.
- (iv) Group restructuring of £0.4 million in 2017 relates to the disposal of the group's operations in France and Germany (refer to Note 34).
- (v) Included within additions is £1.6 million (2017 £3.8 million) from internal development.
- (vi) Refer to Note 21(d) for details on customer contract costs and Note 2 for the effect of initially applying IFRS 15.
- (vii) On 31 December 2018, the group disposed of its subsidiaries ScottishPower Generation Limited and SMW Limited (refer to Note 28).
- (viii) The cost of intangible assets under development at 31 December 2018 was £55.5 million (2017 £72.4 million).

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

6 INTANGIBLE ASSETS *continued*

(b) Impairment test for goodwill

The carrying amount of goodwill for the Renewables business at 31 December 2018 was £364.6 million (2017 £364.6 million).

The recoverable amount for the Renewables business has been determined based on a value-in-use calculation. The calculation uses cash flow projections which reflect past experience and which are based upon a management approved business plan ending in 2027. Cash flows beyond that period reflect asset estimated useful lives as well as management's forward view of prices and the business strategic objectives. It is considered appropriate to assess the cash flows over a period longer than five years as this better reflects the long-term nature of energy market operations and governance, and of wind farm development lead times.

The value-in-use calculation is based on anticipated generation output over the expected lives of individual wind farm projects.

Cash inflows for all projects are based on anticipated generation output. The output is valued at forward power prices based on: observable market information where available; assumed continuing government support through ROCs, CfDs and other mechanisms; and on internal model assumptions. Cash outflows are based on planned operating and capital expenditure.

The main assumptions and basis for determining values assigned to the key assumptions are detailed below:

Main assumptions used for value-in-use calculations	Basis for determining values assigned to key assumptions
Discount rate (pre-tax): onshore 5.72%; and offshore 6.29%	Discount rate is determined on the basis of market data and the divisional cost of capital
Forward price of power	Market quotes/management future expectations
Energy output	Theoretical maximum output less adjustments based on historical data (wind variability, outages and availability)

The value-in-use calculation of the Renewables business exceeds the carrying value.

The group has also performed several sensitivity analyses of the impairment test result in relation to the key assumptions to which the value-in-use calculation is most sensitive, these tests included:

- a 100 basis point increase in the discount rate;
- a 10% decline in the power price per kWh (kilowatt hour) (only applicable to production for which no long-term sales agreements have been entered into); and
- a 5% decline in energy output.

The sensitivity analysis results did not detect the existence of any impairment.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

7 PROPERTY, PLANT AND EQUIPMENT

(a) Movements in property, plant and equipment

	Notes	Total operating plant (Note (b)) £m	Other items of property, plant and equipment in use £m	Plant in progress £m	Other items of property, plant and equipment in progress Restated* £m	Total £m
Year ended 31 December 2017						
Cost:						
At 1 January 2017		13,770.8	365.6	2,742.8	4.3	16,883.5
Additions		161.0	18.6	1,434.3	42.0	1,655.9
Transfers from in progress to plant in use		1,644.8	3.3	(1,626.2)	(21.9)	–
Transfers to intangible assets		(0.5)	–	–	–	(0.5)
Disposals		(92.6)	(68.5)	(1.0)	(1.2)	(163.3)
Group restructuring	(i)	–	(0.1)	(1,143.4)	–	(1,143.5)
Impairment	(ii)	(1.4)	–	(0.1)	(0.1)	(1.6)
Exchange		–	–	46.6	–	46.6
At 31 December 2017		15,482.1	318.9	1,453.0	23.1	17,277.1
Depreciation:						
At 1 January 2017		3,938.0	128.6	–	–	4,066.6
Charge for the year		422.5	14.4	–	–	436.9
Transfer to intangible assets		(0.2)	–	–	–	(0.2)
Disposals		(88.3)	(59.7)	–	–	(148.0)
Impairment	(ii)	(0.4)	–	–	–	(0.4)
At 31 December 2017		4,271.6	83.3	–	–	4,354.9
Net book value:						
At 31 December 2017		11,210.5	235.6	1,453.0	23.1	12,922.2
At 1 January 2017		9,832.8	237.0	2,742.8	4.3	12,816.9
The net book value of property, plant and equipment at 31 December 2017 is analysed as follows:						
Property, plant and equipment in use		11,210.5	235.6	–	–	11,446.1
Property, plant and equipment in the course of construction		–	–	1,453.0	23.1	1,476.1
		11,210.5	235.6	1,453.0	23.1	12,922.2

* Comparative figures have been restated (refer to Note 2).

	Notes	Total operating plant (Note (b)) £m	Other items of property, plant and equipment in use £m	Plant in progress £m	Other items of property, plant and equipment in progress £m	Total £m
Year ended 31 December 2018						
Cost:						
At 1 January 2018		15,482.1	318.9	1,453.0	23.1	17,277.1
Additions		47.0	21.5	960.5	29.6	1,058.6
Transfers from inventories (refer to Note 2A1.1)		–	–	25.8	14.5	40.3
Transfers from in progress to plant in use		476.4	0.1	(440.6)	(35.9)	–
Disposals		(117.1)	(5.1)	–	(1.8)	(124.0)
Disposal of subsidiaries	(iii)	(1,168.3)	(60.9)	(20.7)	(4.4)	(1,254.3)
Impairment	(ii)	(1.6)	–	–	(0.9)	(2.5)
At 31 December 2018		14,718.5	274.5	1,978.0	24.2	16,995.2
Depreciation:						
At 1 January 2018		4,271.6	83.3	–	–	4,354.9
Charge for the year		471.7	15.4	–	–	487.1
Disposals		(112.1)	(5.0)	–	–	(117.1)
Disposal of subsidiaries	(iii)	(668.7)	(1.7)	–	–	(670.4)
Impairment	(ii)	3.1	–	–	–	3.1
At 31 December 2018		3,965.6	92.0	–	–	4,057.6
Net book value:						
At 31 December 2018		10,752.9	182.5	1,978.0	24.2	12,937.6
At 1 January 2018		11,210.5	235.6	1,453.0	23.1	12,922.2
The net book value of property, plant and equipment at 31 December 2018 is analysed as follows:						
Property, plant and equipment in use		10,752.9	182.5	–	–	10,935.4
Property, plant and equipment in the course of construction		–	–	1,978.0	24.2	2,002.2
		10,752.9	182.5	1,978.0	24.2	12,937.6

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

7 PROPERTY, PLANT AND EQUIPMENT *continued*

(b) The movements in total operating plant are analysed as follows:

	Hydro-electric plants £m	CCGTs £m	Wind power plants £m	Gas storage facilities £m	Transmission facilities £m	Distribution facilities £m	Meters and measuring devices £m	Other facilities (Note (iv)) £m	Total operating plant £m
Year ended 31 December 2017									
Cost:									
At 1 January 2017	152.6	937.1	3,417.2	35.6	2,127.1	6,521.6	408.8	170.8	13,770.8
Additions	–	0.4	30.7	0.1	–	4.4	85.1	40.3	161.0
Transfers	–	–	(10.3)	–	–	10.3	(93.5)	93.5	–
Transfers from in progress to plant in use	5.0	20.3	346.5	0.3	768.5	481.4	21.5	1.3	1,644.8
Transfers to intangible assets	(0.4)	–	–	–	–	–	–	(0.1)	(0.5)
Disposals	–	(19.3)	(0.1)	(0.1)	(9.1)	(24.2)	(37.7)	(2.1)	(92.6)
Impairment	–	–	(1.4)	–	–	–	–	–	(1.4)
At 31 December 2017	157.2	938.5	3,782.6	35.9	2,886.5	6,993.5	384.2	303.7	15,482.1
Depreciation:									
At 1 January 2017	87.3	496.4	801.0	14.0	455.2	1,729.1	251.5	103.5	3,938.0
Charge for the year	4.7	33.5	119.4	0.9	56.6	176.4	22.2	8.8	422.5
Transfers	–	–	(6.6)	–	–	6.6	(12.2)	12.2	–
Transfers to intangible assets	(0.2)	–	–	–	–	–	–	–	(0.2)
Disposals	–	(18.7)	(0.1)	(0.1)	(8.8)	(21.0)	(37.7)	(1.9)	(88.3)
Impairment	–	–	(0.4)	–	–	–	–	–	(0.4)
At 31 December 2017	91.8	511.2	913.3	14.8	503.0	1,891.1	223.8	122.6	4,271.6
Net book value:									
At 31 December 2017	65.4	427.3	2,869.3	21.1	2,383.5	5,102.4	160.4	181.1	11,210.5
At 1 January 2017	65.3	440.7	2,616.2	21.6	1,671.9	4,792.5	157.3	67.3	9,832.8
Year ended 31 December 2018									
Cost:									
At 1 January 2018	157.2	938.5	3,782.6	35.9	2,886.5	6,993.5	384.2	303.7	15,482.1
Additions (Note (v))	–	–	(19.3)	–	–	3.6	51.5	11.2	47.0
Transfers from in progress to plant in use	3.3	15.8	47.0	–	101.8	271.0	35.8	1.7	476.4
Disposals	–	(19.8)	(1.6)	(0.4)	(0.5)	(77.5)	(12.9)	(4.4)	(117.1)
Disposal of subsidiaries	(160.5)	(927.8)	–	–	–	–	–	(80.0)	(1,168.3)
Impairment	–	–	(1.6)	–	–	–	–	–	(1.6)
Reclassification	–	(6.7)	–	–	–	–	–	6.7	–
At 31 December 2018	–	–	3,807.1	35.5	2,987.8	7,190.6	458.6	238.9	14,718.5
Depreciation:									
At 1 January 2018	91.8	511.2	913.3	14.8	503.0	1,891.1	223.8	122.6	4,271.6
Charge for the year	5.2	37.1	125.9	0.9	74.1	185.8	25.7	17.0	471.7
Disposals	–	(19.8)	(0.4)	(0.1)	(0.5)	(74.6)	(12.4)	(4.3)	(112.1)
Disposal of subsidiaries	(97.0)	(522.1)	–	–	–	–	–	(49.6)	(668.7)
Impairment	–	0.3	(0.4)	3.2	–	–	–	–	3.1
Reclassification	–	(6.7)	–	–	–	–	–	6.7	–
At 31 December 2018	–	–	1,038.4	18.8	576.6	2,002.3	237.1	92.4	3,965.6
Net book value:									
At 31 December 2018	–	–	2,768.7	16.7	2,411.2	5,188.3	221.5	146.5	10,752.9
At 1 January 2018	65.4	427.3	2,869.3	21.1	2,383.5	5,102.4	160.4	181.1	11,210.5

- (i) Group restructuring of £1,143.5 million in 2017 relates to the disposal of the group's operations in France and Germany (refer to Note 34).
- (ii) The impairment charge of £5.6 million made during the year ended 31 December 2018 comprised write offs of gas storage assets of £3.2 million, operational wind farm assets of £1.2 million and other assets of £1.2 million. The impairment charge of £1.2 million made during the year ended 31 December 2017 primarily comprised the write-off of operational wind farm assets following fire damage.
- (iii) On 31 December 2018, the group disposed of its subsidiaries ScottishPower Generation Limited and SMW Limited (refer to Note 28).
- (iv) The Other facilities category of operating plant largely comprises Energy Networks communications facilities and until 31 December 2018, water treatment facilities (refer to Note 28). Included within other facilities is £30.7 million (2017 £6.2 million) relating to non-operational sites which are not classified as held for sale in accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations'.
- (v) The reduction of £19.3 million in the wind power plant assets in 2018 resulted from a reassessment of future estimated decommissioning costs.
- (vi) Interest on the funding attributable to major capital projects was capitalised during the year at a rate of 1.9% (2017 2.1%).
- (vii) The cost of fully depreciated property, plant and equipment still in use at 31 December 2018 was £451.4 million (2017 £622.0 million).
- (viii) Included within Other operating income in the income statement for the year ended 31 December 2018 is £1.2 million (2017 £1.7 million) relating to compensation receivable from third parties for items of property, plant and equipment that were impaired, lost or given up.
- (ix) Included within the cost of property, plant and equipment at 31 December 2018 are assets in use not subject to depreciation, being land and cushion gas, of £79.9 million (2017 £135.5 million).

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

7 PROPERTY, PLANT AND EQUIPMENT *continued*

(c) Operating lease arrangements

	2018 £m	2017 £m
(i) Operating lease payments		
Minimum lease payments under operating leases recognised as an expense in the year	25.9	25.6
Contingent based operating lease rents recognised as an expense in the year	7.9	2.7
Sublease payments recognised as an expense in the year	–	0.1
	33.8	28.4

The group leases various property, plant and equipment under non-cancellable operating lease arrangements. The leases have varying terms, escalation clauses and renewal rights.

The contingent based operating lease rents primarily relate to certain contracts for land leases where the group has installed wind turbines. The expense recognised represents the invoiced amounts under these contracts.

	2018 £m	2017 £m
(ii) Operating lease commitments		
The future minimum discounted lease payments under non-cancellable operating leases are as follows:		
Within one year	25.7	24.6
Between one and five years	85.2	76.3
More than five years	253.0	209.3
	363.9	310.2

The group leases various property, plant and equipment under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

	2018 £m	2017 £m
(iii) Operating lease receivables		
The future minimum discounted lease payments receivable under non-cancellable operating leases are as follows:		
Within one year	3.1	2.6
Between one and five years	2.7	2.6
More than five years	0.8	0.8
	6.6	6.0

The group leases various property, plant and equipment as a lessor under non-cancellable operating lease arrangements. The leases have varying terms, escalation clauses and renewal rights.

Total sublease rentals recognised as income in the year ended 31 December 2018 amounted to £0.6 million (2017 £1.3 million).

(d) Capital commitments

	2018 £m	2017 £m
Contracted but not provided	1,237.9	1,660.7

(e) Research and development expenditure

The amount of research and development expenditure recognised as an expense during the year was £3.8 million (2017 £6.1 million).

8 INVESTMENTS IN JOINT VENTURES

(a) Movements in investments in joint ventures are analysed as follows:

	Notes	Shares £m	Loans £m	Total £m
At 1 January 2017		8.4	0.3	8.7
Repayment of capital	(i)	(2.0)	–	(2.0)
Repayment of loans		–	(0.3)	(0.3)
Disposals	(ii)	(1.7)	–	(1.7)
Share of result for year		0.9	–	0.9
At 1 January 2018		5.6	–	5.6
Share of result for year		1.3	–	1.3
At 31 December 2018		6.9	–	6.9

(i) On 16 November 2017, the group's 50% joint venture, East Anglia Offshore Wind Limited repaid share capital of £2.0 million to the group.

(ii) On 19 July 2017, the group sold its 50% interest in the share capital of ScotAsh Limited for a consideration of £1.6 million.

(iii) Investments in joint ventures are accounted for using the equity method. Details of the joint ventures are set out in Note 5.

(iv) No quoted market prices exist for investments in joint ventures.

(v) No significant restrictions exist (e.g. resulting from borrowing arrangements, regulatory requirements or contractual arrangements between investors with joint control of or significant influence over a joint venture) that impact upon the ability of joint ventures to transfer funds to the group in the form of cash dividends, or to repay loans or advances made by the group (2017 none).

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

8 INVESTMENTS IN JOINT VENTURES *continued*

(b) Interest in joint ventures

	2018 £m	2017 £m
Aggregate carrying amount of individually immaterial equity accounted interests	6.9	5.6
Aggregate profit from continuing operations attributable to the group	1.3	0.9
Aggregate total comprehensive income attributable to the group	1.3	0.9

The group has no interests in associates.

(c) Commitments

ScottishPower has commitments not recognised as at 31 December 2018 relating to its interests in joint ventures of £25.9 million (2017 £98.4 million).

9 FINANCIAL INSTRUMENTS

The effect of initially applying IFRS 9 on the group's Accounts is detailed in Note 2A3.2. Due to the transition method chosen, comparative information has not been presented to reflect the new requirements.

(a) Carrying value of financial instruments

The table below sets out the carrying amount and fair value of the group's financial instruments that are within the scope of IFRS 9.

Notes	2018			2017 Restated*		
	Carrying amount £m	Fair value £m	Classification under IFRS 9	Carrying amount £m	Fair value £m	Classification under IAS 39
Financial assets						
Other investments	1.1	1.1	FVTPL	1.1	1.1	Available for sale
Finance lease receivables (i)	–	–	N/A	0.5	0.5	N/A
Derivative financial instruments (ii)	234.7	234.7	Fair value hedging instrument	171.6	171.6	Fair value hedging instrument
Non-current receivables (iii)	55.9	55.9	Amortised cost	39.1	39.1	Loans and Receivables
Current receivables (iii)	1,395.0	1,395.0	Amortised cost	1,435.7	1,435.7	Loans and Receivables
Cash (iv)	52.7	52.7	Amortised cost	45.6	45.6	Loans and Receivables
Short-term deposits (v)	686.8	686.8	Amortised cost	–	–	Loans and Receivables
Financial liabilities						
Loans and other borrowings (vi)	(6,147.4)	(6,597.9)	Amortised cost	(5,667.8)	(6,280.9)	Loans and Receivables
Derivative financial instruments (ii)	(103.6)	(103.6)	Fair value hedging instrument	(69.4)	(69.4)	Fair value hedging instrument
Payables (iii)	(1,262.5)	(1,262.5)	Amortised cost	(1,349.9)	(1,349.9)	Loans and Receivables

* Comparative figures have been restated (refer to Note 2A1.2).

The carrying amount of these financial instruments is calculated as set out in Note 3H. With the exception of loans and other borrowings, the carrying value of financial instruments is a reasonable approximation of fair value. The fair value of loans and other borrowings is calculated as set out in footnote (vi) below.

- (i) The carrying value of finance lease receivables is calculated as set out in Note 3F. IAS 39 is only applied to finance lease receivables in respect of derecognition and impairment. IFRS 9, however, requires the new ECL methodology to be applied to leases within the scope of IAS 17.
- (ii) Further detail on derivative financial instruments is disclosed in Note 9(c).
- (iii) Balances outwith the scope of IFRS 7 and IFRS 9 have been excluded, namely prepayments, other tax receivables, payments received on account and other taxes and social security.
- (iv) As a general rule, cash deposited with banks earns interest at rates similar to market rates on daily deposits.
- (v) Short-term deposits mature within a period of less than three months and earn market rates.
- (vi) The fair value of listed debt is calculated using the most recently traded price to the year end date and the fair value of all other loans and borrowings is calculated using a discounted cash flow.

(b) Measurement of financial instruments

The group holds certain financial instruments which are measured in the balance sheet at fair value as detailed in Note 9(a) above. The group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: Quoted (unadjusted) prices in active markets for identical assets or liabilities.
- Level 2: Other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly.
- Level 3: Techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

In both the current and prior year, all other investments held by the group are Level 1. In both the current and prior year, all derivatives held by the group are Level 2.

Included in Level 2 liabilities of £103.6 million (2017 £69.4 million) are inseparable third-party credit enhancements. These have been reflected in the fair value measurement of the liability.

Level 2 commodity derivatives are fair valued by comparing and discounting the difference between the expected contractual cash flows for the relevant commodities and the quoted prices for those commodities in an active market.

Level 2 foreign exchange derivatives comprise cross currency swaps and forward foreign exchange contracts. Cross currency swaps and forward foreign exchange contracts are fair valued using forward exchange rates that are quoted in an active market.

The group recognises transfers between levels of the fair value hierarchy at the end of the reporting period during which the change occurred. There were no transfers in the current or prior year.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

9 FINANCIAL INSTRUMENTS *continued*

(c) Analysis of derivative financial instruments – carrying value

	Note	2018				2017			
		Assets		Liabilities		Assets		Liabilities	
		Current £m	Non- current £m	Current £m	Non- current £m	Current £m	Non- current £m	Current £m	Non- current £m
Hedging derivatives:									
Exchange rate hedges									
Fair value hedge – Currency swap		1.0	51.0	–	–	1.0	43.1	–	–
Cash flow hedge – Foreign exchange rate		3.7	1.5	(0.6)	–	7.2	1.0	(5.3)	–
Commodity hedge – Cash flow hedge		112.4	37.3	(68.3)	(8.6)	46.2	20.5	(10.6)	(1.1)
Non-hedging derivatives:									
Exchange rate derivatives – Foreign exchange rate		0.2	–	–	–	–	–	–	–
Commodity derivatives		326.7	0.4	(324.1)	(1.5)	298.3	1.7	(298.4)	(1.4)
Total gross derivatives		444.0	90.2	(393.0)	(10.1)	352.7	66.3	(314.3)	(2.5)
Impact of netting	(i)	(293.0)	(6.5)	293.0	6.5	(245.4)	(2.0)	245.4	2.0
Total net derivatives in balance sheet		151.0	83.7	(100.0)	(3.6)	107.3	64.3	(68.9)	(0.5)

(i) Certain derivative financial instruments are presented net on the balance sheet. A reconciliation between the gross and net position is provided in Note 9(d).

(d) Offsetting of financial assets and financial liabilities

The group is eligible to present financial assets and financial liabilities net on the balance sheet as described in Note 3H1.3(e). The following table provides information on the impact of offsetting on the consolidated balance sheet as well as the financial impact of the netting of certain instruments in the event of default or similar agreements.

	2018					
	Gross amounts of recognised financial assets/(liabilities) £m	Gross amounts of recognised financial (liabilities)/assets offset in the balance sheet £m	Net amounts of financial assets/(liabilities) presented in the balance sheet £m	Related amounts not offset in balance sheet		
				Financial instruments (Note (ii)) £m	Cash collateral (held)/posted (Notes (ii) and (iii)) £m	Net amount £m
Financial assets						
Receivables	1,793.8	(342.9)	1,450.9	(34.6)	(22.8)	1,393.5
Derivative financial instruments	534.2	(299.5)	234.7	(48.2)	(48.2)	138.3
Financial liabilities						
Payables	(1,605.4)	342.9	(1,262.5)	34.6	22.8	(1,205.1)
Derivative financial instruments	(403.1)	299.5	(103.6)	48.2	–	(55.4)

	2017					
	Gross amounts of recognised financial assets/(liabilities) Restated* £m	Gross amounts of recognised financial (liabilities)/assets offset in the balance sheet £m	Net amounts of financial assets/(liabilities) presented in the balance sheet Restated* £m	Related amounts not offset in balance sheet		
				Financial instruments (Note (ii)) £m	Cash collateral (held)/posted (Notes (ii) and (iii)) £m	Net amount Restated* £m
Financial assets						
Receivables	1,815.9	(341.1)	1,474.8	(31.1)	(3.0)	1,440.7
Derivative financial instruments	419.0	(247.4)	171.6	(34.0)	(44.0)	93.6
Financial liabilities						
Payables	(1,691.0)	341.1	(1,349.9)	31.1	3.0	(1,315.8)
Derivative financial instruments	(316.8)	247.4	(69.4)	34.0	–	(35.4)

* Comparative figures have been restated (refer to Note 2A1.2).

- (i) Certain contracts for derivatives, receivables, and payables in relation to the purchase of gas do not currently meet the offsetting criteria within IAS 32 'Financial Instruments: Presentation' ('IAS 32'), however in the event of default would be required to be offset per the requirements of the contract. The above balances show the effect on the group if these contracts were also offset. Due to the nature of certain contracts, it is not possible to split accurately the effect of offsetting these balances across the derivatives, receivables and payables categories. For presentational purposes the impact has been allocated to receivables and payables as appropriate.
- (ii) The group enters into standard netting agreements with its commodity trading counterparties in order to mitigate the credit risk exposure of the business. In addition, the group utilises collateral support agreements with derivative counterparties to manage its credit exposure. All collateral is settled in cash. These forms of collateral include margining for trading with exchanges, cash collateral used for bilateral and brokering trading as well as letters of credit. At 31 December 2018, the value of letters of credit held amounted to £7.0 million (2017 £27.0 million) and letters of credit posted amounted to £192.4 million (2017 £252.5 million).
- (iii) At 31 December 2018 the group held cash collateral of £7.7 million (2017 £4.4 million) in respect of receivables, of which £7.1 million (2017 all) can be offset against financial assets. At 31 December 2018 the group also posted cash collateral of £36.6 million (2017 £11.6 million) in respect of payables, of which £29.9 million (2017 £7.4 million) can be offset against financial liabilities.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

9 FINANCIAL INSTRUMENTS *continued*

(e) Financial risk management

The group's principal financial liabilities, other than derivatives, comprise loans and borrowings and trade and other payables. The main purpose of these financial liabilities is to finance the group's operations. The group has trade and other receivables, and cash and short-term deposits that arise directly from its operations. The group also holds other investments, finance lease receivables and enters into derivative contracts.

The group has exposure to the following risks arising from the above financial instruments:

- i. Credit risk
- ii. Energy market risk, and
- iii. Treasury risk (comprising both liquidity and market risk).

The group's senior management oversee the management of these risks. Further details of the policies in place to manage exposure to the key risks are detailed below.

Risk management framework

During the year under review, the ScottishPower governance structure was supported by group risk policies adopted by the ScottishPower Board together with relevant risk guidelines that were approved by the ScottishPower Board. The risk limits and indicators within the guidelines were subsequently approved by the Boards of the group's businesses. ScottishPower's business risk assessment teams and the independent group risk management function support the ScottishPower Board in the execution of due diligence and risk management. In addition, the Boards of the group's businesses are responsible for ensuring that their respective business risks are adequately assessed, monitored, mitigated and managed. The UK Risk Director reports on risks for ScottishPower to the ScottishPower Audit and Compliance Committee and such reports are then presented to the ScottishPower Board. ScottishPower's internal audit function also objectively and independently supervises the effectiveness of the group's internal control system, which is made up of a set of risk management and control mechanisms and systems. This is achieved through regular and adhoc audits, the results of which are reported to the Audit and Compliance Committee.

The governance structure, described above, ensured that the risk management policies established for each business to identify, assess, monitor, report, manage and mitigate each of the various types of risk involved in its business were adequately designed and implemented and that an effective and efficient system of internal controls was maintained. The businesses adhered to their specific business risk limits and guidelines which were approved by the ScottishPower Board.

The position on risk and strategy for risk management were contained in the Risk Policy for Iberdrola's businesses in the UK (i.e. ScottishPower). The ScottishPower Board adopted these policies and they were implemented through a rigid risk governance structure, whereby responsibilities were vested with groups, committees and individuals on a global as well as a business level. Generally, the risk management policy and control environment ensures that transactions undertaken and instruments used fall into the types of transactions approved by the ScottishPower Board and are properly validated within the appropriate levels of authority. Transactions include instruments such as physically settled instruments, financially-settled instruments, other contractual obligations, regulatory requirements and other obligations. The types of instruments which can be used are approved for each business. Subject to the limit requirements discussed above, no transaction was executed unless it was an approved instrument. Authorised personnel were permitted to engage only in those activities specified in the business operational policies and procedures.

A clear reporting structure was implemented within the group. It ensures that the portfolios are monitored on a timely basis and sufficient information is made available to management to enable quick response of the business to the dynamic characteristics of its market environment. Those reports include daily position, mark-to-market, Value at Risk ("VaR") reports as well as periodical fundamentals reports, credit watch, credit exposure, accounting and insurance reports.

(i) Credit risk

Credit risk is the risk that a counterparty will not meet its contractual obligations under a financial instrument or customer contract, leading to a financial loss. The group is exposed to credit risk from its operating activities (primarily trade receivables) and from its financing activities, including deposits with banks and financial institutions, foreign exchange transactions and other financial instruments.

The carrying amount of financial assets and contracts represent the maximum credit exposure to the group.

Credit risk management

The group is exposed to both settlement risk (defined as the risk of a counterparty failing to pay for energy and/or services which have been delivered), as well as replacement risk (defined as the risk of incurring additional costs in order to replace a sale or purchase contract following a counterparty default).

Aggregate portfolio risk is monitored and reported by a Credit VaR Monte-Carlo based simulation model to quantify the total credit risk within the existing portfolio.

Further details on the credit risk management strategy adopted for significant types of financial asset are set out below.

- Exposure to credit risk in the supply of electricity and gas arises from the potential customer defaulting on their invoiced payables. The financial strength and credit-worthiness of business customers is assessed prior to commencing, and for the duration of, their contract of supply. Both domestic and business customers' credit worthiness is reviewed from a variety of internal and external information. Internal sources include customer payment history over the duration of the contract, and previous contracts. External information includes customer credit checks.
- Credit risk in respect of other customers is mitigated by contracting with multiple counterparties and limiting exposure to individual counterparties to clearly defined limits based upon the risk of counterparty default.
- The group considers that 100% of its credit risk associated with energy-related derivatives can be considered to be with counterparties in related energy industries, financial institutions operating in energy markets or fellow Iberdrola group companies. At the counterparty level the group employs specific eligibility criteria in determining appropriate limits for each prospective counterparty and supplements this with netting and collateral agreements including margining, guarantees, letters of credit and cash deposits where appropriate.
- Credit risk from balances with banks and financial institutions is managed by the group's treasury department in accordance with Iberdrola's cash investment procedure. Investments of surplus funds are made only with approved counterparties and within credit limits assigned to each counterparty by Corporate Risk Management.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

9 FINANCIAL INSTRUMENTS *continued*

(e) Financial risk management *continued*

(i) Credit risk *continued*

Credit risk management continued

At 31 December 2018 and 2017, the group evaluated the concentration of risk with respect to financial assets as low, with no material concentration of credit risk in the group arising from one particular counterparty.

Expected credit loss assessment

For trade receivables and finance lease receivables the group applies the simplified approach for calculation of ECLs. For all other financial assets measured at amortised cost the group applies the general approach for calculation of ECLs.

Given the varying risk characteristics of the population of trade receivables this balance has been segmented into Energy Retail trade receivables and other trade receivables for disclosure purposes.

Energy Retail trade receivables

The group applies the IFRS 9 simplified model approach to measure the lifetime ECLs which uses a lifetime expected loss allowance for all Energy Retail trade receivables.

The group has adopted the practical expedient whereby it calculates the ECL on Energy Retail's trade receivables using a provision matrix. The provision rates are based upon the customer's payment plan, historical credit loss experience and where possible, adjusted for available forecast information. To establish levels of ECLs the recoverability of equivalent balances from the previous three years has been reviewed.

For large business customers the provision is based upon external credit scoring. The Energy Retail Credit Risk team and the Corporate Risk team also remain vigilant in tracking any liquidity issues on existing customers to identify any pre-emptive actions required. Pre-emptive actions include putting collateral or letters of credit arrangements in place. These receivables are included in the non-aged balances of the table below.

Set out below are the details of the credit risk exposure on Energy Retail's trade receivables:

	Current £m	More than 90 days past due £m	More than 180 days past due £m	More than 12 months past due £m	Non-aged balances Note (a) and (b) £m	Total £m
As at 31 December 2018						
Weighted Average Expected Loss Rate (%)	6.6%	26.6%	37.5%	40.0%	4.2%	16.5%
Gross carrying value: Trade Receivables	140.8	64.4	109.2	106.9	329.9	751.2
Loss allowance	(9.3)	(17.1)	(40.9)	(42.8)	(14.0)	(124.1)
Net carrying value	131.5	47.3	68.3	64.1	315.9	627.1
	Current £m	More than 90 days past due £m	More than 180 days past due £m	More than 12 months past due £m	Non-aged balances Note (a) £m	Total £m
As at 31 December 2017						
Weighted Average Expected Loss Rate (%)	4.7%	25.6%	38.2%	44.7%	3.2%	15.8%
Gross carrying value: Trade Receivables	131.5	58.9	99.8	103.5	343.3	737.0
Loss allowance	(6.2)	(15.1)	(38.1)	(46.3)	(11.1)	(116.8)
Net carrying value	125.3	43.8	61.7	57.2	332.2	620.2

(a) As at 31 December 2018 there is £1.2 million (2017 £0.7 million) that is neither past due nor impaired and £0.2 million (2017 £nil) that is past due but not impaired.

(b) Non-aged balances include large business customers and unbilled receivables (refer to Note 21). The gross carrying amount includes unbilled receivables of £171.5 million which is reflective of gross unbilled receivables of £616.4 million less customer credit balances of £434.9 million and a £10.0 million provision in relation to energy volumes which have still to reach final settlement. The loss allowance in relation to unbilled receivables is £10.0 million. Further information on unbilled receivables, including sensitivity, is detailed in Note 21.

With the exception of large business customers, management considers that where customers are no longer supplied by ScottishPower and have not paid their bills within the last 18 months, collectability is not deemed to be reasonably assured and therefore amounts billed to these customers are written off as uncollectable.

Sensitivity analysis on Energy Retail's loss allowance – billed receivables

Included within the gross carrying amount of trade receivables, within the credit risk exposure table above, £579.7 million relates to billed receivables. The loss allowance in relation to billed receivables is £114.1 million.

In relation to billed receivables the actual level of receivables collected may differ from the estimated levels of recovery, which could impact operating profit positively or negatively. At 31 December 2018, the loss allowance for billed receivables of £114.1 million was supported by a projection based on a 36 month cash collection performance. Based on the weighted average loss rates in the table above a 5% increase in the overall expected loss rate would result in an increase to the loss allowance of £29.0 million. A 5% decrease would result in a decrease to the loss allowance of £29.0 million.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

9 FINANCIAL INSTRUMENTS *continued*

(e) Financial risk management *continued*

(i) Credit risk *continued*

Other trade receivables

The group uses the simplified model approach to measure ECLs for all other trade receivables. The provision rates represent a lifetime ECL and are based on the Iberdrola group's historical loss experience and default rates.

The table below illustrates the ECL on other trade receivables:

	Ageing of trade receivables		
	0-6 months £m	Greater than 6 months £m	Total £m
As at 31 December 2018			
Weighted Average Expected Loss Rate (%)	0.7%	31.1%	1.8%
Gross carrying value	292.5	10.3	302.8
Loss allowance	(2.1)	(3.2)	(5.3)
Net carrying value	290.4	7.1	297.5
	Ageing of trade receivables		
	0-6 months £m	Greater than 6 months £m	Total £m
As at 1 January 2018			
Weighted Average Expected Loss Rate (%)	3.1%	34.5%	4.3%
Gross carrying value	226.9	8.4	235.3
Loss allowance	(7.1)	(2.9)	(10.0)
Net carrying value	219.8	5.5	225.3

Other trade receivables are written off when there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, amongst others, the failure of a debtor to engage in a repayment plan with the group.

Refer to the table on the following page reconciling the movement in the opening to the closing loss allowance.

Security for trade receivables

For some trade receivables the group may obtain security in the form of guarantees, or letters of credit which can be called upon if the counterparty is in default under the terms of the agreement (refer to Note 9(d)). The group does not otherwise require collateral in respect of trade and other receivables.

Other receivables £55.9 million (2017 £39.1 million)

For other receivables the general ECL model is used. The loss allowance is measured at an amount equal to twelve month ECL. However, if the credit risk on that financial instrument has increased significantly since initial recognition, the loss allowance is measured at an amount equal to the lifetime ECL.

The group allocates each exposure to a credit risk grade (probability of default grade) based on data that is determined to be predictive of the risk of loss (including but not limited to external ratings, and available press information about customers) and applying experienced credit judgement. Credit risk grades are defined using qualitative and quantitative factors that are indicative of the risk of default. Where external ratings are not available the Iberdrola Credit Risk department provide the risk ratings. These ratings reflect historical data, current conditions and the group's view of economic conditions over the expected lives of the receivables.

Refer to the table on the following page reconciling the movement in the opening to the closing loss allowance.

Receivables due from Iberdrola group companies and jointly controlled entities – trade and other £10.4 million (2017 £13.9 million)

On initial application of IFRS 9, the group recognised an impairment allowance as at 1 January 2018 of less than £0.1 million. The movement in the ECL in the year to 31 December 2018 was also less than £0.1 million.

Receivables due from Iberdrola group companies – loans and interest £460.0 million (2017: £575.3 million)

The group provides funding in the form of interest bearing on demand loans to other group companies. Credit risk from group companies is considered to be low as the company is part of the Iberdrola group's centralised treasury function and no group company has a credit rating lower than BBB+ (in line with Standards & Poors external credit ratings). ECL on loans due from other Iberdrola group companies is calculated using the general model and therefore a 12 month ECL is applied.

The exposure to credit risk of loans to other group companies (including interest) held at amortised cost by credit rating are set out in the table below:

	As at 31 December 2018			As at 1 January 2018		
	Gross carrying value £m	ECL £m	Amortised Cost £m	Gross carrying value £m	ECL £m	Amortised Cost £m
Credit Rating						
BBB+	460.2	(0.2)	460.0	575.3	(0.3)	575.0

Cash and short-term deposits

The group held cash and short-term deposits of £739.5 million (2017 £45.6 million) at 31 December 2018. The cash and short-term deposits are held with banks and financial institution counterparties, which are rated BBB- to AAA, based on Standard & Poor's ratings.

Impairment on cash and short-term deposits has been measured on a three month expected loss basis and reflects the short maturities of the exposures. The group considers that its cash and short-term deposits have low credit risk based on the external credit ratings of the counterparties.

On initial application of IFRS 9, the group recognised an impairment allowance as at 1 January 2018 of less than £0.1 million. The loss allowance in the year to 31 December 2018 is £0.1 million and is recognised in finance costs.

Guarantees

The group's policy is to provide financial guarantees only for subsidiaries' liabilities.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

9 FINANCIAL INSTRUMENTS *continued*

(e) Financial risk management *continued*

(i) Credit risk *continued*

Reconciliation of opening to closing loss allowance

The closing loss allowances for all financial assets measured at amortised cost, as at 31 December 2018 reconciles to the opening loss allowances as follows:

	Notes	Trade receivables £m	Other receivables £m	Receivables due from Iberdrola group companies – loans and interest £m	Cash and Short Term Deposits £m	Total £m
Balance as at 31 December 2017 under IAS 39		125.8	2.6	–	–	128.4
Adjustment on initial application of IFRS 9		1.0	0.4	0.3	–	1.7
Balance as at 1 January 2018 under IFRS 9		126.8	3.0	0.3	–	130.1
Increase/(decrease) in loss allowance recognised in the income statement	(a),(b)	62.5	(0.4)	(0.1)	0.1	62.1
Utilisation of provision		(59.9)	–	–	–	(59.9)
At 31 December 2018		129.4	2.6	0.2	0.1	132.3

(a) Impairment losses on trade and other receivables per the consolidated income statement of £59.5 million also includes (£2.6) million of associated credit balances.

(b) Impairment losses on loan and interest receivables due from Iberdrola group companies and cash and short term deposits is recognised in finance cost.

The overall increase in the loss allowance for trade and other receivables of £2.2 million from 1 January 2018 is directly related to the rise in gross carrying value offset by the receipt of income for receivables which were previously fully provided for. The movement in the loss allowance of loans and interest from Iberdrola group companies and cash and short-term deposits is directly related to the movement in gross carrying value of these balances.

(ii) Energy market risk

Throughout 2018 and the prior year the group was exposed to market risk associated with fluctuations in the market price of electricity and generation fuel compounded by volumetric risk caused by unplanned changes in the load and output of the portfolio of generation assets. Going forward the group will continue to be exposed to market risk, however given the sale of the generation assets volumetric risk will no longer be impacted by fluctuations in anticipated plant output.

Energy market risk management

The risk management policies are implemented at the business level with the oversight of the businesses' Boards, management teams and the independent risk management function. The group uses a number of risk measurement procedures and techniques to ensure that risk is kept within pre-approved limits. The key measures are stop loss limits and volume exposure by tenor limits. All valuation models are reviewed and approved by the independent group Risk Management function on an ongoing basis, including changes to assumptions and model inputs. Changes that could have had significant impact on the Accounts required additional review and approval by the appropriate Boards.

During 2018 and the prior year the Risk Management function employed additional techniques such as VaR, to assist in measuring risk within the volume exposure by tenor limits. VaR is a key measure of the potential financial loss on a price exposure position over a defined period to a given level of confidence. VaR computations for the group's energy commodity portfolios were based on a historical simulation technique, which utilised historical energy market forward price curve changes to estimate the potential unfavourable impact of price changes in the portfolio positions. The quantification of market risk using VaR provided a consistent measure of risk and sensitivity across the group's continually changing portfolio, however, VaR was not necessarily indicative of actual results that may occur. Future changes in markets inconsistent with historical data or assumptions used could cause variation in actual results to exceed predicted ranges. The group's VaR computations for its energy commodity portfolio utilised several key assumptions, including a 99% confidence level for the resultant price changes and a holding period of five business days. VaR, while sensitive to changes in portfolio volume, does not account for commodity volume risk. Commodity volume risk is defined as the possibility that a change in the supply of, or demand for, the commodity will create an unexpected imbalance and change the requirements for the commodity.

The application of the VaR methodology evolved to include the total forecasted volumes for the generation assets and retail contracts to provide a more accurate measure of the risk associated with the volume exposure by tenor limits. The group's VaR measures are shown in the table below.

	2018 £m	2017 £m
VaR	20.3	28.5
Average VaR over prior year	21.9	31.1
Maximum VaR over prior year	33.6	46.6
Minimum VaR over prior year	11.8	16.3

Hedging of energy market risk

Hedging activities associated with energy market risk are undertaken within the energy management function. The strategy of the business is to mitigate the economic risks associated with electricity generation (up until 31 December 2018), purchase of fuel and supply of electricity and natural gas to end users in both the wholesale and retail markets. From a reporting perspective the objective is to report earnings results that are consistent with its operational strategies and hence recognise the earnings effect of financial and non-financial derivative transactions executed to hedge economic business risks in the same period in which the hedged operational activity impacts earnings. The aim is to minimise earnings volatility, which would otherwise be present as a result of fair valuing all derivative contracts under IFRS 9. To achieve this objective, where effectiveness documentation and reporting requirements are met, cash flow hedge accounting is applied by designation of a series of derivative trades and deferring in equity the fair value changes of open derivative positions until the period in which the forecast transactions occur.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

9 FINANCIAL INSTRUMENTS *continued*

(e) Financial risk management *continued*

(ii) Energy market risk *continued*

Hedging of energy market risk continued

Cash flow hedging strategies are developed for each of the electricity, natural gas, and carbon allowances portfolios to hedge the variability in cash flows associated with changes in the market price of each commodity. Forward (fixed price/fixed volume) contracts are designated as hedging instruments in the electricity, gas, and carbon hedges.

Commodity cash flow hedges

Certain commodity derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the income statement and are included in Finance income or Finance costs.

For an analysis of the split of the carrying value of hedging and non-hedging commodity derivatives refer to Note 9(c).

The amounts relating to commodity derivatives designated as hedging instruments during the year are detailed in the table below:

	Notes	2018 Hedging derivatives £m	2017 Hedging derivatives £m
Notional amount		1,844.4	519.5
Carrying amount – asset	(a)	149.7	66.7
Carrying amount – liability	(a)	(76.9)	(11.7)
Changes in the value of the hedging instrument recognised in OCI	(b)	(17.8)	(8.7)
Hedge ineffectiveness income/(cost) recognised in the income statement	(c)	2.2	(0.2)
Amount reclassified from cash flow hedge reserve to income statement	(d)	(135.6)	5.4

(a) The carrying amount of derivative assets and liabilities are recorded within Derivative financial instruments.

(b) This is consistent with the change in the fair value of the hedging instrument used to calculate ineffectiveness.

(c) The hedge ineffectiveness income/(cost) recognised through the income statement of £2.2 million (2017 (£0.2) million) is included within Procurements.

(d) The amount reclassified from the cash flow hedge reserve to the income statement of £135.6 million (2017 (£5.4) million) is recorded within Gross Margin.

The amounts at the reporting date relating to commodity items designated as hedged items were as follows.

Line item in the Accounts in which the hedged item is/will be included	Change in fair value used for calculating hedge ineffectiveness		Cash flow hedge reserve balance	
	2018 £m	2017 £m	2018 £m	2017 £m
Gross Margin	17.8	8.7	67.5	54.8

The assessment of effectiveness of all hedging relationships currently in place is carried out on a monthly basis as part of the financial reporting cycle. Prospective assessment is carried out at inception of the hedge and on an ongoing basis to verify that the hedge remains effective.

The group determines that the economic relationship between the hedging instrument (the commodity derivative) and the hedged item (the commodity purchases) will virtually always achieve 100% effectiveness. This is because the forecast commodity transaction is implicit within the derivative itself.

Ineffectiveness will arise if the trade has been cancelled, in which case there would be no future transaction. In such circumstances, the trade and the hedge would be eliminated from the accounts. Ineffectiveness will also arise if the group receive notification that the business have been unable to obtain a reliable price forecast from market sources or if there is a change to the Group Risk Management Strategy.

Sensitivity analysis on commodity prices

The sensitivity on the consolidated results to changes in the market prices of the main commodities are as follows:

Commodity	Change in gas price	2018		Variation in price	2017	
		Impact on profit before taxes £m	Impact on equity before taxes £m		Impact on profit before taxes £m	Impact on equity before taxes £m
Gas	+5%	0.1	24.2	+5%	(0.1)	12.0
	-5%	(0.1)	(24.2)	-5%	0.1	(12.0)
Electricity	+5%	–	41.5	+5%	1.6	8.4
	-5%	–	(41.5)	-5%	(1.6)	(8.4)
CO ₂	+5%	–	–	+5%	–	0.2
	-5%	–	–	-5%	–	(0.2)

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

9 FINANCIAL INSTRUMENTS *continued*

(e) Financial risk management *continued*

(iii) Treasury risk

Treasury risk is comprised of liquidity risk and market risk. The group's cash management and short-term financing activity is integrated with Iberdrola's. The group's financing structure is determined by its position in the wider Iberdrola group. The group produces short-term rolling cash-flow requirements and if necessary any required funding is obtained via the group credit facilities already in place. The company holds investment grade ratings with Moody's Investor Services (Baa1), Standard & Poor's Rating Services (BBB+) and Fitch Ratings (BBB+).

Treasury liquidity risk management

The group's liquidity position and short-term financing activities are integrated and aligned with Iberdrola's. Liquidity risk, the risk that the group will have insufficient funds to meet its liabilities, is managed by Iberdrola group Treasury, who are responsible for arranging banking facilities on behalf of the group. For the purposes of the group, Iberdrola is the principal counterparty for the loan balances due to and from the subsidiaries of Scottish Power Limited.

The tables below summarise the maturity profile of the group's financial liabilities as at 31 December based on contractual undiscounted payments.

Financial liabilities (excluding commodity derivatives)

	2018						Total £m
	2019 £m	2020 £m	2021 £m	2022 £m	2023 £m	2024 and thereafter £m	
Cash outflows							
Derivative financial instruments (excluding commodity derivatives)*	30.8	0.1	–	–	–	–	30.9
Loans and other borrowings	3,576.2	142.3	433.7	115.2	355.8	2,594.0	7,217.2
Payables**	1,174.3	3.3	2.4	1.7	–	–	1,181.7
	4,781.3	145.7	436.1	116.9	355.8	2,594.0	8,429.8
	2017 Restated***						Total £m
	2018 £m	2019 £m	2020 £m	2021 £m	2022 £m	2023 and thereafter £m	
Cash outflows							
Derivative financial instruments (excluding commodity derivatives)*	138.6	0.3	0.1	–	–	–	139.0
Loans and other borrowings	2,867.5	299.3	144.0	435.4	117.5	3,071.6	6,935.3
Payables**	1,248.0	2.1	1.0	0.8	0.6	–	1,252.5
	4,254.1	301.7	145.1	436.2	118.1	3,071.6	8,326.8

* The above liquidity analysis is stated after the impact of counterparty netting (refer to Note 9(d)).

** Contractual cash flows exclude accrued interest as these cash flows are included within loans and other borrowings.

*** Comparative figures have been restated (refer to Note 2).

The interest payments on variable interest rate loans and bond issues in the table above reflect market forward interest rates at the reporting date and these amounts may change as market interest rates change.

The future cash flows on derivative instruments (including commodity derivatives below) may be different from the amounts in the table as interest rates and exchange rates or the relevant conditions underlying the calculation change. Except for these financial liabilities, it is not expected that the cash flows included in the maturity analysis could occur significantly earlier, or at significantly different amounts.

The group believes the liquidity risk associated with commodity derivatives needs to be considered in conjunction with the profile of payments in relation to all derivative contracts rather than only those in a liability position.

Commodity derivatives

The group believes the liquidity risk associated with commodity derivatives needs to be considered in conjunction with the profile of payments in relation to all derivative contracts rather than only those in a liability position. It should be noted that cash flows associated with future energy sales and commodity contracts which are not IFRS 9 financial instruments are not included in this analysis, which is prepared in accordance with IFRS 7 'Financial Instruments: Disclosures' ('IFRS 7').

	2018						Total £m
	2019 £m	2020 £m	2021 £m	2022 £m	2023 £m	2024 and thereafter £m	
Net cash outflows	891.0	265.4	50.6	2.3	–	–	1,209.3
	2017						Total £m
	2018 £m	2019 £m	2020 £m	2021 £m	2022 £m	2023 and thereafter £m	
Net cash outflows	191.8	140.9	38.9	4.5	–	–	376.1

Details of the group's contractual commitments are given in Note 31.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

9 FINANCIAL INSTRUMENTS *continued*

(e) Financial risk management *continued*

(iii) Treasury risk *continued*

Treasury market risk management

Market risk is the risk of loss that results from changes in market rates (interest rates and foreign currency). Within the Treasury function the group utilises a number of financial instruments to manage interest rate and foreign currency exposures.

Interest rate risk

In order to adequately manage and limit this risk, the Iberdrola group annually determines the desired structure of the debt between fixed and floating interest rate, taking into account the indexing of income either interest rate or price index. ScottishPower Treasury then take actions over the course of the year to work towards these desired Iberdrola group ratios. Actions to be carried out over the course of a year may include obtaining new sources of financing (at a fixed, floating or indexed rate) and/or utilising interest rate derivatives. The table below shows the debt structure of the group after taking hedging derivatives into account.

Interest rate analysis of debt

	2018 £m	2017 £m
Fixed rate	2,442.8	2,541.3
Variable rate	3,704.6	3,126.5
	6,147.4	5,667.8

The group's borrowings are held at amortised cost. The reference interest rates for the floating rate borrowings are London Inter-Bank Offer Rate ("LIBOR"), Euro Bank Offered Rate ("EURIBOR"), Bank of England Base Rate ("Base") and Retail Prices Index ("RPI").

The variable rate debt consists of a £101.7 million (2017 £93.8 million) Japanese Yen ("JPY") loan, £293.3 million (2017 £283.3 million) inflation linked bonds, £48.2 million (2017 £194.0 million) LIBOR debt, £67.7 million (2017 £85.4 million) EURIBOR debt and a £3,193.7 million (2017 £2,470.0 million) loan linked to Base.

Sensitivity analysis on interest rate changes

The table below illustrates the impact on the annual interest rate charge/(income) considering various rate changes. The analysis assumes all other factors remain constant.

		Interest Rate	Change in rate	Impact on interest rate charges/(income) in 2018 £m	Impact on interest rate charges/(income) in 2017 £m
Loans payable	JPY Debt	(a)	+0.25%	0.1	0.1
			+0.50%	0.3	0.3
			-0.25%	(0.1)	(0.1)
			-0.50%	(0.3)	(0.3)
Loans payable	Inflation linked bonds	RPI	+0.25%	0.7	0.7
			+0.50%	1.5	1.4
			-0.25%	(0.7)	(0.7)
			-0.50%	(1.5)	(1.4)
Loans payable	LIBOR/EURIBOR debt (excluding JPY debt)	LIBOR/EURIBOR	+0.25%	0.3	0.7
			+0.50%	0.6	1.4
			-0.25%	(0.3)	(0.7)
			-0.50%	(0.6)	(1.4)
Loans payable	Short-term variable rate	Base	+0.25%	8.0	6.2
			+0.50%	16.0	12.4
			-0.25%	(8.0)	(6.2)
			-0.50%	(16.0)	(12.4)
Loans receivable	Short-term variable rate	Base	+0.25%	(1.1)	(1.4)
			+0.50%	(2.3)	(2.8)
			-0.25%	1.1	1.4
			-0.50%	2.3	2.8

(a) The interest on the JPY debt is fixed, however this is changed to variable by a cross currency swap. Interest is based on the Sterling LIBOR curve.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

9 FINANCIAL INSTRUMENTS *continued*

(e) Financial risk management *continued*

(iii) Treasury risk *continued*

Foreign Currency Risk

The group is exposed to transactional foreign currency risk to the extent that there is a mismatch between the currencies in which purchases and borrowings are denominated. The currencies in which these transactions are primarily denominated are Euro, US dollars, and Japanese Yen. ScottishPower board policy stipulates that there should be no significant exposure to foreign currency balances and therefore Treasury will hedge all foreign currency payments/contracts which have a (cumulative) value greater than a sterling equivalent of a quarter of a million pounds.

Hedging of foreign currency risk

The group uses a combination of foreign currency swaps and foreign currency forwards to hedge its exposure to foreign currency risk. Under the group's policy the critical terms of the forwards and options must align with the hedged items.

For Treasury related items (hedging the value of currency denominated intercompany loans) the group only designates the spot component of foreign currency forwards in hedge relationships. The spot component is determined with reference to relevant spot market exchange rates. The differential between the contracted forward rate and the spot market exchange rate is defined as the forward points. The changes in the forward element of the foreign currency forwards that relate to hedged items are deferred in the costs of hedging reserve.

The group also enters into foreign currency forwards in relation to commodity and asset purchases. For such items the group designates the entire value of the foreign currency forward in the hedge relationship.

Some asset purchases and commodity purchase foreign exchange contracts do not satisfy the requirements for hedge accounting (economic hedges) under IFRS 9. These foreign currency forwards are subject to the same risk management policies as all other derivative contracts. However, they are accounted for as held for trading with gains (losses) recognised in the income statement.

The table below illustrates the timing of the notional amount of the hedging instrument and the average forward price of the hedging instrument.

As at 31 December 2018	Notional amount of hedging instrument (maturity profile)					
	1 year	2 years	£million 3 years	4 years	5 years	Total
USD	63.2	3.1	9.1	–	51.4	126.8
EUR	173.6	2.9	–	–	–	176.5
DKK	1.6	1.0	2.0	–	–	4.6
	238.4	7.0	11.1	–	51.4	307.9

As at 31 December 2018	Average forward price (exchange rate)				
	1 year	2 years	3 years	4 years	5 years
USD (GBP: USD)	1.30	1.43	1.44	–	1.59
EUR (GBP: EUR)	1.12	1.1	–	–	–
DKK (GBP: DKK)	8.76	8.64	8.72	–	–

Further details on the group's foreign currency cash flow hedges and fair value hedges are set out below.

Foreign exchange rate cash flow hedges

Hedging of commodity purchases: Where commodities are priced in a currency other than Sterling, the foreign exchange risk may be hedged using forward foreign exchange contracts. These are designated as cash flow hedges where they comply with the requirements of IFRS 9.

Hedging of asset purchases: The group is subject to cash flow risk resulting from the purchase of various assets which are denominated in foreign currencies. The risk being hedged relates to the fluctuation in the functional currency terms of value of these foreign currency denominated purchases. The group enters into forward foreign exchange rate contracts to hedge those risks.

Hedging the value of foreign currency denominated intercompany loans: The group has provided funding to or received funding from other Iberdrola companies denominated in currencies other than Sterling. The value of the group's assets or liabilities in relation to this funding is subject to foreign exchange risk. As a result, the group enters into cross currency swaps or foreign exchange rate contracts as hedges and has designated those within a cash flow hedging relationship where they meet required hedging criteria.

For an analysis of the split of the carrying value of foreign exchange contracts please refer to Note 9(c).

The amounts relating to foreign exchange rate derivatives designated as cash flow hedges during the year are detailed in the table below.

	Notes	2018 Hedging derivatives £m	2017 Hedging derivatives £m
Notional amount		256.5	490.8
Carrying amount – asset	(a)	5.2	8.2
Carrying amount – liability	(a)	(0.6)	(5.3)
Changes in the value of the hedging instrument recognised in OCI	(b)	(1.6)	23.4
Hedge ineffectiveness cost recognised in the income statement	(c)	(0.3)	–
Amount reclassified from cash flow hedge reserve to income statement	(d)	1.6	(0.5)
Amount reclassified from cash flow hedge reserve to balance sheet	(e)	(1.7)	(21.3)

(a) The carrying amount of derivative assets and liabilities are recorded within Derivative financial instruments.

(b) This is consistent with the change in the fair value of the hedging instrument used to calculate ineffectiveness.

(c) The hedge ineffectiveness recognised through the income statement of £0.3 million (2017 £nil) is included within Finance costs.

(d) The amount reclassified from the cash flow hedge reserve to the income statement is recorded within External services (£0.2) million (2017 £nil), Gross margin £0.2 million (2017 £0.5 million) and Finance costs £1.6 million (2017 £nil).

(e) The amount reclassified from the cash flow hedge reserve to balance sheet is included within Intangibles £nil (2017 (£0.1) million), Property, plant and equipment in the course of construction £1.7 million (2017 £21.3 million) and Property, plant and equipment in use £nil (2017 £0.1 million).

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

9 FINANCIAL INSTRUMENTS *continued*

(e) Financial risk management *continued*

(iii) Treasury risk *continued*

The amounts at the reporting date relating to foreign exchange items designated as hedged items were as follows.

Line item in the Accounts in which the hedged item is/will be included	Change in fair value used for calculating hedge ineffectiveness		Cash flow hedge reserve balance	
	2018 £m	2017 £m	2018 £m	2017 £m
Gross margin	–	(0.1)	–	–
Property, plant and equipment in the course of construction	0.6	(21.7)	52.5	50.8
Property, plant and equipment in use	0.1	(0.2)	0.2	0.1
External services	0.9	(1.4)	1.7	0.7
Total	1.6	(23.4)	54.4	51.6

The group determines that the economic relationship between the hedging instrument (the foreign exchange rate forward contract) and the hedged item (the commodity purchases/asset purchase) will virtually always achieve 100% effectiveness. This is because the group compares movements in the fair value of the expected highly probable forecast foreign currency cash flows, with movements in the fair value of the expected changes in cash flows from the hedging instrument. Forecast future foreign currency cash flows are largely based upon contractual obligations.

Ineffectiveness will arise if the trade has been cancelled, in which case there would be no future transaction. Ineffectiveness will also arise if the group receive notification that the business has been unable to obtain a reliable price forecast from market sources or if there is a change to the group Risk Management Strategy.

Fair value hedges

Hedging the value of cross currency debt: The group has issued debt instruments denominated in JPY. The value of the group's liability with respect to those instruments is subject to foreign exchange risk and interest rate risk. As a result the group has entered into cross-currency swaps and has designated these within a fair value hedging relationship where they meet the required hedging criteria to mitigate this risk. The carrying value of the associated 10 billion JPY loan is £101.7 million (2017 £93.8 million).

	Notes	As at 31 December 2018	As at 31 December 2017
Notional amount (£m)		51.4	51.4
Carrying amount – asset (£m)	(a)	52.0	44.1
Change in fair value of the hedging instrument used in calculating hedge ineffectiveness (£m)		(2.5)	6.8
Change in fair value of hedged item used to calculate ineffectiveness (£m)	(b)	2.5	(6.8)
Hedge ratio		1:1	1:1
Hedge rate (£:JPY)		1:194.55	1:194.55

(a) The carrying value of the fair value currency swap is included within derivative financial instruments on the balance sheet.

(b) The change in value of hedged items used to calculate hedge ineffectiveness is included within Loans and other borrowings.

Hedge assessment on foreign currency derivatives

Hedge assessment on foreign currency derivatives is done prospectively to verify that the forecast transactions are still highly probable of occurring (for cash flow hedges) as well as retrospectively, to assess the effectiveness in the period under review. Prospective assessment is performed using sensitivity analysis and critical terms matching.

Sensitivity analysis on foreign currency cash flows

No sensitivity analysis has been performed in relation to changes in foreign exchange rates as almost all foreign currency purchases and all foreign currency loans are hedged. Therefore there is immaterial financial exposure. Any movement in the value of the hedged item would be compensated for by movement in the value of the hedging instrument.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

10 TRADE AND OTHER RECEIVABLES

	Notes	2018 £m	2017 Restated* £m
Current receivables:			
Receivables due from Iberdrola group companies – trade		4.4	8.6
Receivables due from Iberdrola group companies – loans	(a)	451.9	565.7
Receivables due from Iberdrola group companies – interest		8.1	9.6
Receivables due from jointly controlled entities – trade		3.2	1.4
Receivables due from jointly controlled entities – other		2.8	3.9
Trade receivables (including accrued income)	(b)	924.6	846.5
Prepayments		27.0	59.6
Other tax receivables		18.3	18.4
		1,440.3	1,513.7
Non-current receivables:			
Prepayments		16.5	14.1
Other receivables	(c)	55.9	39.1
		72.4	53.2

* Comparative figures have been restated (refer to Note 2).

(a) Current loans due from Iberdrola group companies are receivable on demand with interest linked to the Bank of England base rate.

(b) Certain trade receivables and payables are presented net on the balance sheet when the offsetting criteria under IAS 32 are met (refer to Note 3H1.3(e)). A reconciliation between the gross and net position is provided in Note 9(d).

(c) This balance represents other receivables recognised as part of a contractual renegotiation.

(d) Information about the group's exposure to credit and market risks, and impairment losses for trade and other receivables are included in Note 9(e).

(e) Trade and other receivables includes £746.0 million of IFRS 15 receivables (refer to Note 21(c)).

11 INVENTORIES

	Notes	2018 £m	2017 Restated* £m
Fuel stocks		15.4	10.6
Emissions allowances		0.9	13.6
ROCs		223.4	234.3
Other inventories	(a)	530.9	205.5
	(b)	770.6	464.0

* Comparative figures have been restated (refer to Note 2).

(a) Other inventories primarily comprises a transmission asset which will be sold to an offshore transmission operator once it has been completed.

(b) Inventories with a value of £457.9 million (2017 £419.5 million – as restated) were recognised as an expense during the year.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

12 SHARE CAPITAL

	2018 £m	2017 £m
Allotted, called up and fully paid shares:		
4,383,983,102 ordinary shares of 50p each (2017 4,383,983,102)	2,192.0	2,192.0

- (a) Holders of these ordinary shares are entitled to dividends as declared from time to time; amounts on the capitalisation of profits and reserves; and notice and attendance at general meetings of the company, with every member entitled to one vote on a show of hands and on a poll one vote for every share held.

13 ANALYSIS OF MOVEMENTS IN EQUITY ATTRIBUTABLE TO EQUITY HOLDER OF SCOTTISH POWER UK PLC

	Share capital (Note (a)) £m	Share premium (Note (b)) £m	Hedge reserve (Note (c)) £m	Translation reserve (Note (d)) £m	Other reserves (Note (e)) £m	Retained earnings (Note (f)) £m	Total £m
At 1 January 2017	872.0	398.2	79.2	0.3	14.0	2,650.5	4,014.2
Profit for the year attributable to equity holder of Scottish Power UK plc	–	–	–	–	–	425.9	425.9
Share capital issued	1,320.0	–	–	–	–	–	1,320.0
Changes in the value of cash flow hedges	–	–	8.9	–	–	–	8.9
Actuarial losses on retirement benefits	–	–	–	–	–	(222.9)	(222.9)
Tax on items relating to cash flow hedges	–	–	(1.7)	–	–	–	(1.7)
Tax on items relating to actuarial losses on retirement benefits	–	–	–	–	–	36.4	36.4
Exchange movement on translation of overseas results and net assets	–	–	–	0.2	–	–	0.2
Group restructuring	–	–	–	(0.5)	–	–	(0.5)
Dividends	–	–	–	–	–	(300.0)	(300.0)
At 1 January 2018	2,192.0	398.2	86.4	–	14.0	2,589.9	5,280.5
Adjustments due to IFRS 9	–	–	–	–	–	(1.3)	(1.3)
Adjustments due to IFRS 15	–	–	–	–	–	40.8	40.8
Adjusted balance at 1 January 2018	2,192.0	398.2	86.4	–	14.0	2,629.4	5,320.0
Profit for the year attributable to equity holder of Scottish Power UK plc	–	–	–	–	–	818.3	818.3
Changes in the value of cash flow hedges	–	–	15.5	–	–	–	15.5
Actuarial losses on retirement benefits	–	–	–	–	–	(48.2)	(48.2)
Tax on items relating to cash flow hedges	–	–	(3.0)	–	–	–	(3.0)
Tax on items relating to actuarial losses on retirement benefits	–	–	–	–	–	8.2	8.2
Capital contribution	–	–	–	–	412.2	–	412.2
Realisation of revaluation reserve	–	–	–	–	(5.7)	–	(5.7)
Dividends	–	–	–	–	–	(563.2)	(563.2)
At 31 December 2018	2,192.0	398.2	98.9	–	420.5	2,844.5	5,954.1

- (a) On 5 October 2017, the company issued 2,640,000,000 ordinary shares at 50p each, to its immediate parent, Scottish Power Limited, for a total consideration of £1,320.0 million.
- (b) The share premium account represents consideration received for shares issued in excess of their nominal amount.
- (c) The hedge reserve represents the balance of gains and losses on cash flow hedges (net of taxation) not yet transferred to income or the carrying amount of a non-financial asset.
- (d) The translation reserve represented the accumulated exchange differences on the translation of the results and net assets of foreign subsidiaries.
- (e) Other reserves at 31 December 2018 comprises a capital redemption reserve of £8.3 million (2017 £8.3 million), a revaluation reserve of £nil (2017 £5.7 million) and a capital contribution reserve of the £412.2 million (2017 £nil). The capital redemption reserve represents the cumulative nominal value of shares repurchased and cancelled by the company. The revaluation reserve comprised the revaluation of assets which arose on the purchase of the remaining 50% of the equity share capital of a former joint venture which was realised on the disposal of ScottishPower Generation Limited (refer to Note 28). During the year, a capital contribution of £412.2 million was recognised following the waiver of an intercompany loan of £412.2 million by Scottish Power Limited, the group's parent company, to ScottishPower Generation Limited prior to its sale.
- (f) Retained earnings comprise the cumulative balance of profits and losses recognised in the financial statements as adjusted for transactions with shareholders, principally dividends.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

13 ANALYSIS OF MOVEMENTS IN EQUITY ATTRIBUTABLE TO EQUITY HOLDER OF SCOTTISH POWER UK PLC *continued*

(g) The changes in the hedge reserve arising from valuation adjustments to hedging derivatives is set out below:

	Cost of hedging reserve £m	Commodity hedges £m	Foreign exchange rate hedges £m	Gross value of hedges £m	Tax effect £m	Total £m
Analysis of cash flow hedge reserve						
At 1 January 2017	–	25.4	72.1	97.5	(18.3)	79.2
Effective cash flow hedges recognised	–	23.8	1.3	25.1	(4.8)	20.3
De-designated cash flow hedges	–	0.2	–	0.2	–	0.2
Removed from equity and recognised in income statement	–	5.4	(0.5)	4.9	(0.9)	4.0
Removed from equity and recognised in carrying amount of hedged items	–	–	(21.3)	(21.3)	4.0	(17.3)
At 1 January 2018	–	54.8	51.6	106.4	(20.0)	86.4
Effective cash flow hedges recognised	–	150.5	4.2	154.7	(29.5)	125.2
De-designated cash flow hedges	–	(2.2)	0.3	(1.9)	0.4	(1.5)
Removed from equity and recognised in income statement	–	(135.6)	–	(135.6)	25.8	(109.8)
Removed from equity and recognised in carrying amount of hedged items	–	–	(1.7)	(1.7)	0.3	(1.4)
Cost of hedging reserve – change in fair value	(1.6)	–	–	(1.6)	0.3	(1.3)
Cost of hedging reserve – reclassified to income statement	1.6	–	–	1.6	(0.3)	1.3
At 31 December 2018	–	67.5	54.4	121.9	(23.0)	98.9

(i) On first application of IFRS 9 on 1 January 2018, the group designated only the spot element of fair value forward contracts as a hedging instrument. The cost of the hedging reserve reflects the gains and losses on the forward element of these forward exchange contracts.

(ii) The maturity analysis of amounts included in the hedge reserve is as follows:

	2018 £m	2017 £m
Less than 1 year	62.7	40.3
1-2 years	33.2	35.4
2-3 years	3.1	10.1
3-4 years	(0.1)	0.6
	98.9	86.4

14 NON-CONTROLLING INTERESTS

	£m
At 1 January 2017	0.6
Net profit attributable to non-controlling interests	0.2
Group restructuring	0.1
At 1 January 2018	0.9
Net profit attributable to non-controlling interests	0.3
Dividends paid to non-controlling interests	(0.2)
At 31 December 2018	1.0

15 DEFERRED INCOME

DEFERRED INCOME					
	At 1 January 2017 £m	Receivable during year £m	Released to income statement £m	Disposals £m	At 31 December 2017 £m
Year ended 31 December 2017					
Capital grants	0.4	–	–	–	0.4
Transfer of assets from customers	1,106.9	115.3	(35.3)	(3.7)	1,183.2
Emissions allowances allocated	–	0.1	(0.1)	–	–
Total deferred income	1,107.3	115.4	(35.4)	(3.7)	1,183.6
	At 1 January 2018 £m	Receivable during year £m	Released to income statement £m	Disposal of subsidiaries (Note (b)) £m	At 31 December 2018 £m
Year ended 31 December 2018					
	Note				
Capital grants		0.4	(0.1)	(0.4)	–
Transfer of assets from customers	(a)	1,183.2	(39.1)	–	1,213.0
Emissions allowances allocated		–	(0.1)	–	–
Total deferred income		1,183.6	(39.3)	(0.4)	1,213.0

(a) On first application of IFRS 15 on 1 January 2018, transfer of assets from customers is an IFRS 15 contract liability (refer to Note 21(c)).

(b) On 31 December 2018, the group disposed of its subsidiaries ScottishPower Generation Limited and SMW Limited (refer to Note 28).

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

16 RETIREMENT BENEFIT OBLIGATIONS

(a) Analysis of balance

The amounts recognised in the balance sheet in respect of retirement benefit obligations are detailed below:

	2018 £m	2017 £m
Non-current liabilities	512.7	564.8

(b) Group pension arrangements

The group operates the following pension schemes for staff:

Scheme	Scottish Power Pension Scheme ("SPPS")	Manweb Group of Electricity Supply Pension Scheme ("Manweb")	Stakeholder Pension Plan
Type of benefit	Final salary	Final salary	Defined contribution
New entrants	No *	No	Yes
Funded separately from group assets	Yes	Yes	Yes
Administration method	Trustee board	Trustee board	Insurance contract
Member contributions	5% of salary	5.5% of salary	5% of salary
Group contributions – how determined	Agreement of Trustees and group following actuarial valuation (last valuation: 31 March 2015)	Agreement of Trustees and group following actuarial valuation (last valuation: 31 March 2015)	Defined
Current actual group contributions	48% of salary	45% of salary	Service-related, 6% to 14% of salary
Special contributions during year ended 31 December 2018	£52.0 million	£40.5 million	None
Special contributions planned for year ending 31 December 2019	£53.7 million	£41.8 million	None
Pension charge	Based on advice of independent qualified actuary	Based on advice of independent qualified actuary	Equal to actual group contributions in the year

* A number of members of the Stakeholder Pension Plan were entitled to defined benefits for future service upon achieving ten years of membership. The company has withdrawn this option and therefore there is no benefit accrual for Stakeholder members.

The age profile of the two final salary schemes is expected to rise over time, due to the reduction in new entrants. This will in turn result in increasing service costs for these two schemes due to the actuarial valuation method used (the projected unit method). The group believes that the projected unit method continues to be appropriate at present, and provides a reasonable basis for assessing the group's final salary pension costs.

Group pension scheme governance

As described in the table above, the group operates two defined benefit pension schemes. Active members continue to accrue benefits in the schemes, which are based on final pensionable salary. The two schemes are closed to new entrants. The schemes provide benefits which are based on final pensionable salary.

On 31 December 2018 the group completed the sale of ScottishPower Generation Limited and SMW Limited to Drax Smart Generation HoldCo Limited. From this date, Drax have taken responsibility for 109 active members of SPPS who were part of the Generation business that has been transferred. It was agreed that as soon as reasonably practicable, Drax would establish or nominate a suitable pension scheme capable of accepting a bulk transfer of liabilities for these active members. The transferring Generation subsidiaries will participate in SPPS on a temporary basis during 2019 whilst Drax finalise their pension arrangements for these active members. It has been assumed that the liabilities for these active members and an associated share of assets on a share of fund basis have been transferred on 31 December 2018. To the extent that a transfer is not agreed and no transfer payment is made to the Drax pension arrangement, ScottishPower UK plc as principal employer would remain liable for the past service liabilities remaining in SPPS for these members.

The schemes are approved by HMRC and subject to standard UK pensions and tax law. The defined benefit schemes are subject to the scheme funding requirements as set out in section 224 of the Pensions Act 2004. In accordance with the scheme funding requirements, an actuarial funding valuation is carried out at least triennially to determine the appropriate level of ongoing contributions for both future service and a recovery plan in respect of any deficit at the valuation date. These actuarial valuations will be based on assumptions agreed between the Trustees and the group. The assumptions used to calculate liabilities (or technical provisions) in a triennial funding valuation may differ from those used in IAS 19 accounting. The Trustees are required to set assumptions prudently, whereas IAS 19 assumptions are set with regard to the group's best estimates. Additionally, the discount rate used to value technical provisions will take into account the scheme investment strategy, rather than being based on the yield on AA corporate bonds as required under IAS 19. The most recent completed actuarial valuation was as at the effective date of 31 March 2015.

In accordance with UK trust and pensions law, the defined benefit pension schemes are governed by their respective Board of Trustees. Although the group meets the financial cost of running the schemes, the Trustees are responsible for the management and governance of the schemes and have a duty to act in the best interests of the members.

The strategic management of the assets is the responsibility of the Trustees acting on expert advice. The Trustees take advice from the schemes' actuaries and investment advisers with a view to investing the schemes' assets in a manner that is appropriate to the nature and duration of the expected future retirement and death benefits payable from the schemes. In consultation with the group, the Trustees have set out a target investment strategy for the schemes of 40% matching and 60% growth assets. In terms of the matching portfolio, the schemes utilise a Liability Driven Investment ("LDI") strategy. The aim of the LDI portfolio is to invest in a range of assets (mostly bonds) which broadly match the expected future benefit payments from the schemes.

In addition, the Trustees of the ScottishPower Pension Scheme and the Trustees of the Manweb Group of Electricity Supply Pension Scheme have implemented longevity swaps in December 2014 and July 2016 respectively. For further details, please see the Mortality risk section that follows.

Following the decision by the UK to exit the EU, there has been significant market volatility in asset prices and yields on investments. Despite the Bank of England's recent decision to increase base interest rates, long-term yields on both government and corporate bonds continue to remain low and liabilities are still at high levels. Negotiations between the UK and the EU continue following the extension to the exit deadline to 31 October 2019. The Trustees continue to monitor how decisions impact on the schemes from an investment and legal perspective based on expert advice.

Risk management

The defined benefit schemes expose the group to actuarial risks and details of the specific risks and how they are managed are described below:

Investment (market) risk: there is a risk relating to changes in the value of the portfolio due to movements in the market value of the assets. To the extent that there is a mismatch between the investment strategy and the overall level and profile of the liabilities this can lead to volatility in the funding level and as the portfolio matures there is a risk of not being able to reinvest assets at the assumed rates. The Trustees utilise an LDI strategy which aims to invest 40% of the assets in matching LDIs such as bonds, which broadly match the nature and profile of the future expected benefit payments from the scheme. The Trustees have further diversified the market risk in the growth portfolio across multiple asset types, such as equities, property, diversified growth funds, infrastructure, private and mezzanine debt and multi-asset credit. Through diversification, the specific risk associated with individual investments is mostly mitigated and expected volatility of returns is reduced. In addition, the Trustees review the investment strategy on a regular basis to ensure that it remains appropriate and in particular in response to legislative changes, a material change in the schemes' funding levels or changes in the attitude to risk of the Trustees or group.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

16 RETIREMENT BENEFIT OBLIGATIONS *continued*

(b) Group pension arrangements *continued*

Risk management

Mortality risk: the assumptions adopted by the group make allowance for future improvements in life expectancy. There is a risk that life expectancy improves faster than assumed and that benefits are paid for longer than expected, thereby increasing the cost of the schemes. The group and the Trustees regularly review the actual scheme mortality experience to minimise the risk of using an inappropriate assumption. In general, the Trustees will also use prudent assumptions when deriving the triennial actuarial valuation basis used for funding requirements and this will help to manage the risk.

In December 2014, the Trustees of SPPS implemented a longevity swap in respect of the current pensioners. The swap removes the previously unhedged longevity risk for the current pensioners (who constitute approximately 50% of the total liability of the scheme) and their contingent spouses by hedging the risk of members covered by the contract living longer than expected. The swap is an insurance contract between SPPS and the counterparty insurer. Counterparty risk is mitigated by both SPPS and the counterparty posting collateral to the other party on a daily basis to account for market movements in the value of the derivatives held.

In July 2016, the Trustees of Manweb also implemented a longevity swap in respect of the current pensioners. The swap removes the previously unhedged longevity risk for the current pensioners (who constitute approximately 50% of the total liability of the scheme) and their contingent spouses by hedging the risk of members covered by the contract living longer than expected. The swap is an insurance contract between Manweb and the counterparty insurer. Counterparty risk is mitigated by both Manweb and the counterparty posting collateral to the other party on a daily basis to account for market movements in the value of the derivatives held.

Interest rate risk: a fall in the yield on government bonds increases both the liabilities and assets of the schemes. To the extent that the assets do not fully match the nature and duration of the liabilities, this could lead to a worsening in the funding position of the schemes. The Trustees currently target 40% of the schemes' investments in LDI which include matching assets such as fixed interest bonds. The interest rate hedging strategy adopted within the LDI portfolio provides partial protection against the impact of changes in yields. Around 60% of the interest rate risk is currently hedged on a technical provisions basis. Under the de-risking framework agreed between the group and the Trustees, the level of interest rate hedging will be increased when market conditions are deemed favourable. As the level of hedging increases, funding level volatility will be further reduced.

Inflation rate risk: the majority of the schemes' liabilities increase in line with inflation, subject to relevant caps and collars. To the extent that inflation is higher than expected, this will increase the liabilities of the schemes. The schemes' target investment strategy is to invest 40% of the portfolio in LDI investments which will include bonds which are also linked to inflation. The inflation hedging strategy adopted within the LDI portfolio provides partial protection against the impact of changes in inflation. Around 70% of the inflation rate risk is currently hedged on a technical provisions basis. Under the de-risking framework agreed between the group and the Trustees, the level of inflation rate hedging will be increased when market conditions are deemed favourable. As the level of hedging increases, funding level volatility will be further reduced.

Each of the pension schemes is invested in an appropriately diversified range of assets. The broad proportion of each asset class in which the schemes aim to be invested are as follows, however it is important to note that this may vary from time to time as markets change and as cash may be held for strategic reasons.

	2018	2017
Equities	16%	15%
Infrastructure	3%	3%
Liability driven investment	40%	49%
Property	6%	4%
Mezzanine debt	6%	5%
Diversified growth funds	16%	16%
Multi-asset credit	13%	8%
Total	100%	100%

Additional pension arrangement: The group also operates an Unfunded Unapproved Retirement Benefit Scheme ("UURBS") for former senior executives' benefit promises in excess of limits set by the UK taxation authorities. The UURBS has no invested assets, and the group has provided £5.3 million as at 31 December 2018 (2017 £5.8 million) for the benefit promises which will ultimately be paid by the group.

In addition to the defined benefit schemes described above, the group also operates a defined contribution scheme which is open to new entrants. This scheme is a contract based arrangement to which both the group and the employee contribute.

(c) Pensions – defined contribution scheme

The charge for the year ended 31 December 2018 in respect of the Stakeholder Pension Plan is £11.2 million (2017 £8.4 million).

(d) Pensions – defined benefit schemes

The group operates defined benefit pension schemes as described earlier in this note. Formal actuarial valuations were carried out as described earlier and updated to 31 December 2018 by a qualified independent actuary. The major assumptions applied by the actuary are given in footnote (e) overleaf.

(i) Analysis of net liability relating to pension:	2018 £m	2017 £m
Present value of funded obligations	(4,915.9)	(5,477.9)
Fair value of scheme assets	4,408.5	4,918.9
Net liability of funded plans	(507.4)	(559.0)
Present value of unfunded obligations	(5.3)	(5.8)
Net liability	(512.7)	(564.8)
Amounts in the balance sheet:		
Non-current liabilities	(512.7)	(564.8)
Net liability	(512.7)	(564.8)

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

16 RETIREMENT BENEFIT OBLIGATIONS *continued*

(d) Pensions – defined benefit schemes *continued*

(ii) The amounts recognised are as follows:	2018 £m	2017 £m
Current service cost	58.1	58.4
Past service cost*	(9.7)	31.1
GMP Equalisation**	2.9	–
Disposal of subsidiaries	(4.8)	–
Net interest cost on defined benefit obligation/scheme assets	12.1	9.4
Administration expenses	3.1	2.7
Total income statement charge	61.7	101.6
Actual return on scheme assets	(179.8)	225.9
Net actuarial losses recognised in the consolidated statement of comprehensive income	(48.2)	(222.9)

* Past service costs in 2017 primarily include the pension costs recognised following the announcement of a group wide restructuring programme during 2017. Following completion of the 2017 restructuring programme, the surplus past service costs were released.

** On 26 October 2018, a landmark pensions case was handed down by the High Court, which has confirmed that pension schemes are required to equalise Guaranteed Minimum Pensions ("GMP"). The cost of equalising GMPs has been estimated to be £2.9 million and this has been recognised as a past service cost via the income statement.

(iii) Changes in the present value of the defined benefit obligations are as follows:	2018 £m	2017 £m
Defined benefit obligation at beginning of year	(5,483.7)	(5,330.4)
Current service cost	(58.1)	(58.4)
Interest on obligation	(136.5)	(149.9)
Scheme members' contributions	(6.7)	(7.5)
Past service costs	9.7	(31.1)
GMP Equalisation	(2.9)	–
Actuarial gains/(losses):		
Actuarial gains arising from changes in demographic assumptions	40.2	161.1
Actuarial gains/(losses) arising from changes in financial assumptions	144.1	(510.0)
Actuarial gains arising from changes of the scheme experience different to that assumed	71.7	40.6
Disposal of subsidiaries	57.3	–
Benefits paid	443.7	401.9
Defined benefit obligation at end of year	(4,921.2)	(5,483.7)
Analysis of defined benefit obligation		
Plans that are wholly or partly funded	(4,915.9)	(5,477.9)
Plans that are wholly unfunded	(5.3)	(5.8)
Total	(4,921.2)	(5,483.7)

The defined benefit obligations for SPPS are 29% (2017 32%) in respect of active scheme participants, 15% (2017 16%) in respect of deferred scheme participants and 56% (2017 52%) in respect of retirees. The weighted average duration of the defined benefit obligation as at 31 December 2018 is 19 years.

The defined benefit obligations for Manweb are 29% (2017 33%) in respect of active scheme participants, 9% (2017 10%) in respect of deferred scheme participants and 62% (2017 57%) in respect of retirees. The weighted average duration of the defined benefit obligation as at 31 December 2018 is 17 years.

(iv) Changes in the fair value of scheme assets are as follows:	2018 £m	2017 £m
Fair value of scheme assets at beginning of year	4,918.9	4,887.9
Interest income on scheme assets	124.4	140.5
Return on assets in excess of interest income	(304.2)	85.4
Employer contributions	162.0	202.2
Scheme members' contributions	6.7	7.5
Administration expenses	(3.1)	(2.7)
Disposal of subsidiaries	(52.5)	–
Benefits paid	(443.7)	(401.9)
Fair value of scheme assets at end of year	4,408.5	4,918.9

(e) Actuarial assumptions

(i) The assumptions used by the actuary for the pensions arrangements, for all schemes, were as follows and are expressed as weighted averages:

	2018	2017
Rate of increase in salaries	3.8% p.a.	3.7% p.a.
Rate of increase in deferred pensions	3.3% p.a.	3.2% p.a.
Rate of increase to pensions in payment	3.2% p.a.	3.1% p.a.
Discount rate	2.8% p.a.	2.6% p.a.
Inflation assumption	3.3% p.a.	3.2% p.a.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

16 RETIREMENT BENEFIT OBLIGATIONS *continued*

(e) Actuarial assumptions *continued*

(ii) The weighted average life expectancy for mortality used to determine the benefit obligations were as follows:

Member age 63 (current life expectancy)	2018	2017
Male	24.5	24.8
Female	25.7	25.9
Member age 45 (life expectancy at age 63)		
Male	25.8	26.5
Female	27.3	27.7

(iii) The post-retirement mortality assumptions are as follows:

Post-retirement mortality assumptions

Base tables – 90% S2PMA/100% S2PFA (ill health members have a +6 year age rating) (2017 same)

Allowance for future improvements – CMI 2017 with a 1.25% (2017 CMI 2016 with a 1.5% improvement rate) long-term improvement rate.

(iv) The sensitivity analysis below has been calculated by varying the critical actuarial assumption whilst keeping all other assumptions constant. Liabilities are calculated using the same method and membership data as that used to derive the defined benefit obligation. As well as impacting on salary growth, a change in inflation also impacts on other inflation linked assumptions such as increases to deferred pensions and pensions in payment. This sensitivity applies to the defined benefit obligation only and not to the net defined benefit pension liability in its entirety, the measurement of which is driven by a number of factors including, in addition to the assumptions below, the fair value of scheme assets. There has been no change to the method year on year to assess the sensitivity of the results to changes in the critical actuarial assumptions.

	Increase/(decrease) in defined benefit obligation	
	2018 £m	2017 £m
Sensitivity analysis of critical actuarial assumptions		
Rates of increase in inflation and salary growth		
Increase by 0.1%	86.7	103.3
Decrease by 0.1%	(84.4)	(100.5)
Discount rate		
Increase by 0.25%	(215.8)	(257.4)
Decrease by 0.25%	231.5	277.2
Assumed life expectancy		
Increase mortality by one additional year	195.0	204.7

(v) Allowance for cash commutation:

Within SPPS, members are assumed to commute 25% of their benefits for a tax-free cash sum. It has been assumed that Manweb members do not commute any additional amounts above the tax free cash lump sum benefit to which they are already entitled.

(vi) The following table provides information on the composition and fair value of plan assets of the SPPS and Manweb pension schemes.

SPPS Scheme	2018					2017				
	Level 1	Level 2	Level 3	Total	Plan asset allocation	Level 1	Level 2	Level 3	Total	Plan asset allocation
	£m	£m	£m	£m	%	£m	£m	£m	£m	%
Equities	584.7	–	–	584.7	17.6%	704.3	–	–	704.3	19.1%
Infrastructure	–	–	118.2	118.2	3.6%	–	–	113.6	113.6	3.1%
Liability driven instrument	857.0	85.1	–	942.1	28.4%	1,450.1	31.1	–	1,481.2	40.1%
Property	0.5	–	238.6	239.1	7.2%	0.4	–	193.3	193.7	5.3%
Cash	140.0	–	–	140.0	4.2%	216.7	–	–	216.7	5.9%
Mezzanine/private debt	–	–	232.5	232.5	7.0%	–	–	149.3	149.3	4.0%
Diversified growth funds	536.1	–	–	536.1	16.1%	559.1	–	–	559.1	15.2%
Multi-asset credit	17.4	498.2	12.4	528.0	15.9%	52.7	215.9	1.6	270.2	7.3%
Fair value of scheme assets	2,135.7	583.3	601.7	3,320.7	100.0%	2,983.3	247.0	457.8	3,688.1	100.0%

Manweb Scheme	2018					2017				
	Level 1	Level 2	Level 3	Total	Plan asset allocation	Level 1	Level 2	Level 3	Total	Plan asset allocation
	£m	£m	£m	£m	%	£m	£m	£m	£m	%
Equities	165.3	–	–	165.3	15.2%	199.0	–	–	199.0	16.2%
Infrastructure	–	–	35.5	35.5	3.2%	–	–	34.1	34.1	2.8%
Liability driven instrument	391.2	34.9	–	426.1	39.2%	518.6	27.2	–	545.8	44.3%
Property	0.1	–	11.6	11.7	1.1%	–	–	–	–	–
Cash	67.1	–	–	67.1	6.2%	88.8	–	–	88.8	7.2%
Mezzanine/private debt	–	–	57.5	57.5	5.3%	–	–	24.3	24.3	2.0%
Diversified growth funds	228.2	–	–	228.2	21.0%	239.0	–	–	239.0	19.4%
Multi-asset credit	(1.9)	96.1	2.2	96.4	8.8%	28.4	70.2	1.2	99.8	8.1%
Fair value of scheme assets	850.0	131.0	106.8	1,087.8	100.0%	1,073.8	97.4	59.6	1,230.8	100.0%
Total				4,408.5					4,918.9	

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

16 RETIREMENT BENEFIT OBLIGATIONS *continued*

(e) Actuarial assumptions *continued*

(vii) The scheme assets do not include any of the group's own financial instruments, nor any property occupied by, or other assets used by, the group. No scheme held ScottishPower or Iberdrola shares in 2018 or 2017.

The group uses the value of the variation collateral posted as the fair value of the longevity swaps for SPPS and Manweb. The amount of collateral posted is calculated and agreed between insurer and scheme custodian. The valuation takes into consideration current market conditions at the balance sheet date. This allows for the difference between the present value of cash flows allowing for the schemes actual mortality experience and current expectations of future longevity experience and the present value of cash flows using the longevity assumptions agreed at the inception of the swaps. As at 31 December 2018, the value of the variation collateral for SPPS was £218.2 million and the value of for Manweb was £28.3 million and these have been allowed for as a reduction to the cash value.

Under the rules of each scheme, the Trustees cannot unilaterally wind-up the schemes and the group would be able to assume gradual settlement of the liabilities over time until all members have left. Having then triggered a wind-up, any remaining surplus would revert to the group. Furthermore, the power to amend the rules of each scheme lies with the group and the Trustees cannot unilaterally improve benefits under the schemes. Therefore, the group has an unconditional right to a refund under IFRIC 14 'IAS 19 – The Limit of a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' and thus there is no requirement to restrict any IAS 19 surplus, should it arise, nor to recognise any additional liabilities in respect of minimum funding requirements.

(f) Future contributions

The group expects to contribute £152.5 million to the pension schemes in the year ending 31 December 2019, based on the agreement with scheme Trustees following the valuation at March 2015. Based on the valuation at 31 March 2015, similar levels of contributions are expected in future years.

17 OTHER PROVISIONS

Year ended 31 December 2017	Notes	At 1 January 2017 £m	New provisions £m	Unwinding of discount £m	Utilised during year £m	Released during year £m	At 31 December 2017 £m
Reorganisation and restructuring	(a)	6.0	4.1	–	(4.5)	(1.1)	4.5
Decommissioning and environmental	(b)	199.3	31.2	3.2	(2.6)	(0.1)	231.0
Emissions allowances	(c)	23.7	13.4	–	(23.7)	–	13.4
Renewables obligation	(d)	260.0	402.8	–	(337.8)	–	325.0
Onerous contracts	(e)	8.7	0.2	0.2	(1.4)	–	7.7
Insurance	(f)	3.6	1.3	–	(0.2)	(0.9)	3.8
Other	(g)	5.1	3.3	–	(1.1)	–	7.3
		506.4	456.3	3.4	(371.3)	(2.1)	592.7

Year ended 31 December 2018	Notes	At 1 January 2018 £m	New provisions £m	Unwinding of discount £m	Utilised during year £m	Released during year £m	Disposal of subsidiaries (Note (h)) £m	At 31 December 2018 £m
Reorganisation and restructuring	(a)	4.5	7.2	–	(7.0)	–	–	4.7
Decommissioning and environmental	(b)	231.0	(19.3)	3.3	(3.1)	–	(12.4)	199.5
Emissions allowances	(c)	13.4	27.3	–	(13.6)	–	(27.0)	0.1
Renewables obligation	(d)	325.0	431.7	–	(435.9)	–	–	320.8
Onerous contracts	(e)	7.7	–	0.2	(1.4)	(1.3)	–	5.2
Insurance	(f)	3.8	1.4	–	–	(0.9)	–	4.3
Other	(g)	7.3	13.0	–	(1.0)	(2.4)	(0.5)	16.4
		592.7	461.3	3.5	(462.0)	(4.6)	(39.9)	551.0

Analysis of total provisions	2018 £m	2017 £m
Non-current	208.3	231.8
Current	342.7	360.9
	551.0	592.7

- (a) The provision for reorganisation and restructuring largely relates to group wide restructuring programmes launched during 2017 and 2018 with the balance of both programmes to be utilised in 2019.
- (b) The provision for decommissioning and environmental costs is the discounted future estimated costs of decommissioning the group's generating plants and in 2017 the obligation to remove asbestos from power stations over the course of their operational lives. The decommissioning of this plant is expected to occur over the period between 2019 and 2056. The reduction of £19.3 million in the provision in 2018 resulted from a reassessment of future estimated costs.
- (c) The provision for emissions allowances represents the value of emissions allowances certificates expected to be delivered in 2019.
- (d) The provision for renewables obligation principally represents the value of ROCs for 2018 expected to be delivered in 2019 and 2020.
- (e) The provision for onerous contracts principally relates to various property leases. These leases will expire between 2019 and 2025.
- (f) The provision for insurance principally represents the value of claims reserves. The claims are expected to be settled between 2019 and 2020.
- (g) The Other category at 31 December 2018 comprises a provision in respect of an ongoing legal dispute regarding the alleged use of unlicensed software. No amount has been disclosed on the grounds it may be seriously prejudicial. The dispute is expected to be settled during 2019. The remaining provision comprises a contractual dispute of £5.0 million (2017 nil) and other provisions which are not individually sufficiently material to warrant separate disclosure.
- (h) On 31 December 2018, the group disposed of its subsidiaries ScottishPower Generation Limited and SMW Limited (refer to Note 28).

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

18 LOANS AND OTHER BORROWINGS

(a) Analysis by instrument and maturity

	Notes	Interest rate ^a	Maturity	2018 £m	2017 £m
Bank overdraft		Base + 1%	On demand	–	0.1
Loans with Iberdrola group companies		Base + 1%	On demand	3,190.7	2,469.9
Loan with joint venture		Base + 1%	On demand	3.0	–
Loans with Iberdrola group companies	(ii)	LIBOR + 0.34%	17 December 2018	–	150.0
Loans with Iberdrola group companies		3.858%	29 January 2019	150.0	150.0
Collateral		LIBOR	17 June 2019	48.2	44.0
£300 million medium-term note	(iii)	5.9%	22 February 2021	298.6	297.9
Loans with Iberdrola group companies	(iv)	EURIBOR + 1.025%	28 March 2022	67.7	85.4
£250 million euro-sterling bond	(v), (vi)	6.75%	29 May 2023	249.3	249.1
£175 million inflation linked bond	(iii), (vii)	3.494% x RPI	13 October 2024	293.3	283.3
£350 million euro-sterling bond	(v), (viii)	5.875%	17 July 2026	347.8	347.5
£350 million euro-sterling bond	(v), (ix)	4.875%	20 September 2027	347.1	346.8
Loans with Iberdrola group companies		2.66%	20 December 2027	–	100.0
Loans with Iberdrola group companies		3.05%	20 December 2027	900.0	900.0
10 billion JPY loan	(x)	4.6%	27 July 2029	101.7	93.8
£50 million medium-term note	(iii)	5.75%	9 December 2039	50.0	50.0
£100 million medium-term note	(iii)	6.375%	31 May 2041	100.0	100.0
				6,147.4	5,667.8

^a Base - Bank of England Base Rate; LIBOR - London Inter-Bank Offer Rate; EURIBOR - Euro Bank Offered Rate; RPI - Retail Price Index; JPY - Japanese Yen.

Analysis of total loans and other borrowings

	Note	2018 £m	2017 £m
Non-current		2,737.7	2,986.4
Current	(i)	3,409.7	2,681.4
		6,147.4	5,667.8

- (i) Current borrowings comprise loans with Iberdrola group companies repayable on demand or within the next year, the short-term element of the EURIBOR 2022 loan with Iberdrola (refer to footnote (iv) below) and collateral together with finance costs due to be amortised within one year, the short-term element of fair value hedge adjustments and the adjustments on discontinued fair value hedges due to be amortised within one year, which totalled £(1.4) million (2017 £(1.8) million).
- (ii) This loan has the interest rate reset at pre-determined dates, this includes the ability to adjust the margin rate as deemed appropriate by both parties.
- (iii) The company and Scottish Power Limited have an established joint US\$7 billion euro medium-term note programme. Scottish Power Limited has not issued under the programme. SPUK has in issue various notes in Sterling which can be redeemed by SPUK with 30 to 90 days' notice in case of unfavourable and unavoidable changes in the UK tax laws impacting on the note payments.
- (iv) The EURIBOR loan with Iberdrola that is due to mature in March 2022 has a schedule of repayments which commenced in 2014. The repayment of £19.2 million due in 2019 (2017 £19.2 million due in 2018) is classified as current in the above analysis.
- (v) These bonds contain a "Loss of licences" covenant that will require repayment of the outstanding amount should the group lose all of their electricity licences (distribution, transmission and supply licences).
- (vi) The euro-sterling bond due in 2023 can be redeemed at any time by the group at the higher of principal amount or redemption price (as determined by HSBC Bank plc) giving 30 to 45 days' notice to the lender.
- (vii) The group has external debt that contain loan covenants. A future breach of covenants may require the group to repay the loans earlier than indicated in the above table. Under the agreements, the covenants are monitored on a regular basis by the group Treasury department and regularly reported to management to ensure compliance with the agreements.
- (viii) The £350 million euro-sterling bond will be redeemed at its principal amount on 17 July 2026 unless previously redeemed or purchased and cancelled. The bond can be redeemed at any time by the group at a higher redemption price (as determined by a financial advisor appointed by the group and Guarantor) giving 30 to 60 days' notice.
- (ix) The £350 million euro-sterling bond will be redeemed at its principal amount on 20 September 2027 unless previously redeemed or purchased and cancelled. The bond can be redeemed at any time by the group at a higher redemption price (as determined by a financial advisor appointed by the group and Guarantor) giving 30 to 60 days' notice.
- (x) The interest rate quoted above on the 10 billion JPY loan is fixed. This is changed to a variable rate by a cross currency swap.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

18 LOANS AND OTHER BORROWINGS *continued*

(b) Reconciliation of movements of liabilities to cash flows arising from financing activities

	Liabilities			Total £m
	Loans and other borrowings (Current) £m	Loans and other borrowings (Non-current) £m	Interest payable (Current) (Note (i)) £m	
Balance as at 1 January 2017	4,184.9	2,698.1	109.4	6,992.4
(Decrease)/increase in amounts due to Iberdrola group companies	(1,147.3)	989.7	–	(157.6)
(Repayments of)/cash inflows from borrowings	(206.3)	1.1	–	(205.2)
Interest paid	–	–	(169.7)	(169.7)
Total movements from financing cash flows	(1,353.6)	990.8	(169.7)	(532.5)
Movements arising from group restructuring	(311.1)	(574.8)	(4.0)	(889.9)
Foreign exchange movement	8.8	28.4	0.2	37.4
Fair value and other non-cash movements	2.4	(6.1)	(29.6)	(33.3)
Other movements	150.0	(150.0)	191.1	191.1
Total liability-related other movements	(149.9)	(702.5)	157.7	(694.7)
Balance as at 31 December 2017	2,681.4	2,986.4	97.4	5,765.2

	Liabilities			Total £m
	Loans and other borrowings (Current) £m	Loans and other borrowings (Non-current) £m	Interest payable (Current) (Note (i)) £m	
Balance as at 1 January 2018	2,681.4	2,986.4	97.4	5,765.2
Increase/(decrease) in amounts due to Iberdrola group companies	862.0	–	–	862.0
Cash inflows from borrowings	7.2	–	–	7.2
Interest paid	–	–	(185.3)	(185.3)
Total movements from financing cash flows	869.2	–	(185.3)	683.9
Fair value and other non-cash movements	19.2	1.3	(32.2)	(11.7)
Other movements	(160.1)	(250.0)	200.9	(209.2)
Total liability-related other movements	(140.9)	(248.7)	168.7	(220.9)
Balance as at 31 December 2018	3,409.7	2,737.7	80.8	6,228.2

(i) External interest payable of £38.0 million (2017 £37.9 million) and internal interest payable of £42.8 million (2017 £59.5 million) are included within Trade and other payables (refer to Note 19).

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

19 TRADE AND OTHER PAYABLES

	Notes	2018 £m	2017 Restated* £m
Current trade and other payables:			
Payables due to Iberdrola group companies – trade		9.9	8.8
Payables due to Iberdrola group companies – capital		1.8	2.1
Payables due to Iberdrola group companies – interest		42.8	59.5
Payables due to jointly controlled entities – trade		5.4	3.4
Trade payables	(a), (b)	621.9	535.7
Other taxes and social security		62.0	68.6
Payments received on account	(c)	151.3	136.7
Capital payables and accruals		429.2	542.7
Other payables	(c)	144.1	193.2
		1,468.4	1,550.7
Non-current other payables:			
Payments received on account		27.9	29.2
Other payables		7.4	4.5
		35.3	33.7

* Comparative figures have been restated (refer to Note 2).

- (a) Trade payables include amounts due on commodity activities.
- (b) Certain trade payables and receivables are presented net on the balance sheet when offsetting criteria under IAS 32 are met (refer to Note 3H1.3(e)). A reconciliation between the gross and net position is provided at Note 9(d).
- (c) Trade and other payables includes £217.0 million of IFRS 15 contract liabilities (refer to Note 21(c)).

20 DEFERRED TAX

Deferred tax provided in the Accounts is as follows:

	Notes	Property, plant and equipment £m	Derivative financial instruments £m	Retirement benefits £m	Other temporary differences £m	Total £m
At 1 January 2017		782.5	24.2	(82.1)	(8.3)	716.3
Charge/(credit) to income statement		37.4	(3.9)	19.2	(1.7)	51.0
Group restructuring	(a)	–	–	–	6.0	6.0
Recorded in the statement of comprehensive income		–	1.7	(36.4)	–	(34.7)
Exchange		–	–	–	(0.4)	(0.4)
At 1 January 2018		819.9	22.0	(99.3)	(4.4)	738.2
Adjustments due to IFRS 9		–	–	–	(0.4)	(0.4)
Adjustments due to IFRS 15		–	–	–	9.3	9.3
Adjusted balance at 1 January 2018		819.9	22.0	(99.3)	4.5	747.1
Charge/(credit) to income statement		34.0	(0.1)	19.1	(5.2)	47.8
Disposal of subsidiaries	(b)	(44.2)	–	–	0.9	(43.3)
Recorded in the statement of comprehensive income		–	3.0	(8.2)	–	(5.2)
At 31 December 2018		809.7	24.9	(88.4)	0.2	746.4

- (a) Group restructuring of £6.0 million in 2017 relates to the disposal of the group's operations in France and Germany (refer to Note 34).
- (b) On 31 December 2018, the group disposed of its subsidiaries ScottishPower Generation Limited and SMW Limited (refer to Note 28).
- (c) At 31 December 2018, the group had unutilised capital losses of £25.8 million (2017 £26.0 million). No deferred tax asset has been recognised in the Accounts due to the unpredictability of suitable future profit streams against which these losses may be utilised.
- (d) Legislation has been enacted to reduce the rate of UK Corporation Tax to 17% on 1 April 2020. This reduces the tax rates expected to apply when temporary differences reverse and impacts the deferred tax charge.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

21 REVENUE FROM CONTINUING OPERATIONS

The effect of initially applying IFRS 15 on the group Accounts is detailed in Note 2.A.3.1.

(a) Disaggregation of revenue for the year ended 31 December 2018

	Note	Energy Networks £m	Renewables £m	Energy Wholesale and Retail £m	Total £m
Segment revenue		1,167.4	540.3	3,919.9	5,627.6
Inter-segment revenue	(i)	(143.2)	(484.1)	(6.6)	(633.9)
External revenue		1,024.2	56.2	3,913.3	4,993.7
Electricity distribution		616.8	–	–	616.8
Electricity transmission		368.3	–	–	368.3
Transfers of assets from customers		39.1	–	–	39.1
Supply of electricity		–	–	2,777.6	2,777.6
Supply of gas		–	–	1,075.5	1,075.5
Other		–	56.2	60.2	116.4
		1,024.2	56.2	3,913.3	4,993.7

(i) Energy Networks inter-segment revenue is predominantly subject to regulation and is based on published tariffs set by Ofgem. Renewables inter-segment revenue primarily consists of the sale of electricity and ROCs from wind farms. Energy Wholesale and Retail inter-segment revenue largely consists of the supply of electricity and gas.

All revenue is recognised over time and arises from operations within the UK and Republic of Ireland. Revenue arising outside the UK is not deemed material enough to warrant separate disclosure.

(b) Accounting policies and of estimation uncertainties

The group recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the group expects to be entitled in exchange for those goods and services.

(i) Electricity distribution

The group provides a service of making its distribution network available to customers. This performance obligation is satisfied over time as the customer simultaneously receives and consumes the benefits of the group's performance as it makes the distribution network available. The group has a right to consideration in an amount that corresponds directly with the value to the customer of the group's performance to date. Revenue is therefore recognised in the amount to which the group has a right to invoice based on the amount of allowed revenue for the year set by the price control. Due to the nature of the electricity settlements industry process, revenue includes unbilled income recognised as a receivable relating to units transferred over the network but not yet invoiced at the end of the year. Invoices are raised a month in arrears and are typically settled within a month.

(ii) Electricity transmission

The group provides a service of making its transmission network available to the Great Britain system operator. This performance obligation is satisfied over time as the customer simultaneously receives and consumes the benefits of the group's performance as it makes the transmission network available. The customer benefits from the group's service (of making the transmission network available) evenly throughout the year and therefore time is used to measure progress towards complete satisfaction of the performance obligation. Revenue is recognised on a straight-line basis throughout the year based on the amount of allowed revenue for the year set by the price control.

Invoices are typically raised and settled on a monthly basis and therefore there are no related IFRS 15 receivables, contract assets or contract liabilities at the end of the year.

(iii) Transfers of assets from customers

Pursuant to the applicable industry regulations, the group occasionally receives contributions from its customers for the construction of grid connection facilities, or is assigned assets that must be used to connect those customers to a network. Both the cash received and the fair value of the facilities received are credited to Deferred income in the consolidated balance sheet (this is a contract liability). Revenue is subsequently recognised in line with the period over which the facilities are depreciated.

(iv) Supply of electricity and gas

The group's performance obligations are the supply of gas and/or electricity to customers. These performance obligations are both satisfied over time as the customer simultaneously receives and consumes the benefits of the group's performance as it supplies gas and electricity. The group has a right to consideration in an amount that corresponds directly with the value to the customer of the group's performance to date. Revenue is therefore recognised in the amount to which the group has a right to invoice based on the value of units supplied during the year and the tariff agreed with the customer.

The nature of the energy industry in the UK, in which the group operates, is such that revenue recognition is subject to a degree of estimation. The assessment of energy sales to customers utilises external data supplied by the electricity and gas market settlement process and internal data relating to energy purchases where settlement data is not yet available. At the end of each year, amounts of energy delivered to customers are estimated and the corresponding billed and unbilled revenue is estimated and recorded in Revenue.

Billed revenue relating to the group's retail customers included within the consolidated balance sheet at 31 December 2018 amounts to £465.6 million, which includes £114.1 million of expected credit losses. The gross amount of billed revenue on the balance sheet is £579.7 million. Gross unbilled revenue included within the consolidated balance sheet at 31 December 2018 amounts to £616.4 million. This is before applying customer credit balances of £434.9 million, a £10.0 million provision in respect of expected credit losses and a £10.0 million provision in relation to energy volumes which have still to reach final settlement. This results in a net unbilled position of £161.5 million which relates primarily to energy delivered in the final months of the year. For further details on expected credit losses, refer to Note 9(e).

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

21 REVENUE FROM CONTINUING OPERATIONS *continued*

(b) Accounting policies of estimation uncertainties *continued*

(iv) Supply of electricity and gas *continued*

Had actual consumption been 5% higher or lower than the estimate of units supplied (using a blended average rate), this would have resulted in revenue recognised for unbilled amounts being £30.8 million higher or lower respectively. Approximately 95% of unbilled revenue relates to the most recent quarter where there is a higher level of estimation uncertainty.

Invoices are generally raised on a monthly or quarterly basis which customers typically settle on a monthly or quarterly basis respectively, with the exception of prepayment customers who pay in advance. Billed and unbilled revenue is recorded in receivables. Amounts in contract liabilities consist of direct debit customer payments that are in excess of the associated units of energy delivered and final customer credits.

(v) Other revenue

Other revenues are recognised based on the consideration specified in a contract with a customer, to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur in the future. The group recognises revenue either at a specific point in time or over a period of time based on when control is transferred to the customer based on the performance obligations in the contract.

(c) Contract balances

	Notes	31 December 2018 £m	1 January 2018 £m
Receivables	(i)	746.0	744.4
Contract liabilities	(ii), (iii)	(1,430.0)	(1,440.0)

(i) Included within Trade and other receivables (refer to Note 10).

(ii) £1,213.0 million (1 January 2018 £1,183.2 million) of contract liabilities relates to the transfer of assets from customers which is recorded within Deferred income (refer to Note 15). The remainder is included with Trade and other payables (refer to Note 19).

(iii) The amount of contract liabilities recognised as income in the year is £125.4 million.

(iv) £65.3 million of impairment losses were recognised during the year on receivables arising from the group's contracts with customers.

(v) There was no significant movement in the contract liabilities.

(d) Contract costs

The group capitalises the incremental costs of obtaining certain customer contracts, principally sales commissions, if they are expected to be recovered. These are recorded as a separate asset class within Intangible assets and amortised on a systematic basis according to the average expected life of contracts with customer that are associated with such costs. The amortisation period is between two and four years.

The group has elected to apply the amortisation period to a portfolio of contracts with similar characteristics as the group expects that the effect on the financial statements is not materially different from applying it to the individual contracts.

During the year £53.2 million of incremental costs of obtaining a contract (customer contract costs) were capitalised and the amortisation charge was £25.5 million (refer to Note 6). In the comparative period, such costs were recognised in External services in the consolidated income statement as incurred.

22 EMPLOYEE INFORMATION FOR CONTINUING OPERATIONS

(a) Staff costs

	Note	2018 £m	2017 Restated* £m
Wages and salaries		276.5	264.9
Social security costs		29.8	28.4
Pension and other costs	(i)	82.0	112.6
Total staff costs		388.3	405.9
Less: capitalised staff costs		(157.8)	(141.6)
Charged to the income statement		230.5	264.3

* Comparative figures have been restated to reflect continuing operations only (refer to Note 28).

(i) Pension and other costs includes a credit of £2.5 million (2017 £37.7 million of costs as adjusted) for group wide restructuring programmes.

(b) Employee numbers

The year end and average numbers of employees (full and part-time) employed by the group, including UK based directors, were:

	Year end 2018	Average 2018	Year end 2017 Restated*	Average 2017 Restated*
Energy Networks	3,009	2,993	3,014	2,876
Renewables	395	377	367	304
Energy Wholesale and Retail	1,696	1,791	1,849	1,974
Corporate	511	517	531	503
Total	5,611	5,678	5,761	5,657

* Comparative figures have been restated to reflect the transfer of employees as part of the sale of the Generation group (refer to Note 28).

The year end and average numbers of full-time equivalent staff employed by the group, including UK based directors, were:

	Year end 2018	Average 2018	Year end 2017 Restated*	Average 2017 Restated*
Total	5,434	5,491	5,562	5,473

* Comparative figures have been restated to reflect the transfer of employees as part of the sale of the Generation group (refer to Note 28).

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

23 TAXES OTHER THAN INCOME TAX ON CONTINUING OPERATIONS

	Note	2018 £m	2017 Restated* £m
Property taxes		114.3	110.3
Other taxes	(a)	73.0	102.2
		187.3	212.5

* Comparative figures have been restated to reflect continuing operations only (refer to Note 28).

(a) Other taxes mainly comprises obligations specific to the energy industry, principally ECO and WHD.

24 DEPRECIATION AND AMORTISATION CHARGE, ALLOWANCES AND PROVISIONS ON CONTINUING OPERATIONS

	2018 £m	2017 Restated* £m
Property, plant and equipment depreciation charge	441.2	395.1
Intangible asset amortisation charge	64.7	59.5
Charges and provisions, allowances and impairment of assets	7.1	5.1
	513.0	459.7

* Comparative figures have been restated to reflect continuing operations only (refer to Note 28).

25 FINANCE INCOME FROM CONTINUING OPERATIONS

	2018 £m	2017 £m
Interest on bank and other deposits	0.2	0.2
Interest receivable from Iberdrola group companies	8.1	9.5
Interest receivable from jointly controlled entities	0.2	0.1
Foreign exchange gains	3.0	2.9
Fair value and other gains on financing derivatives	0.6	2.7
	12.1	15.4

26 FINANCE COSTS FROM CONTINUING OPERATIONS

	Note	2018 £m	2017 Restated* £m
Interest on bank loans and overdrafts		0.3	0.1
Interest on amounts due to Iberdrola group companies		72.1	60.0
Interest on other borrowings		104.1	105.4
Unwinding of discount on provisions		3.3	3.2
Foreign exchange losses		2.4	3.2
Net interest on retirement benefit obligations		12.1	9.4
Fair value and other losses on financing derivatives		1.6	3.5
Reversal of impairment		–	(0.4)
		195.9	184.4
Capitalised interest	(a)	(17.0)	(16.9)
		178.9	167.5

* Comparative figures have been restated to reflect continuing operations only (refer to Note 28).

(a) The tax relief on the capitalised interest for the year ended 31 December 2018 was £2.5 million (2017 £1.8 million).

(b) The ECL calculated on treasury related financial assets amounted to less than £0.1 million in the year.

27 INCOME TAX ON CONTINUING OPERATIONS

	2018 £m	2017 Restated* £m
Current tax:		
UK Corporation Tax charge on profits for the year	97.8	48.9
Adjustments in respect of prior years	(6.8)	(3.6)
Current tax for the year	91.0	45.3
Deferred tax:		
Origination and reversal of temporary differences	58.7	54.8
Adjustments in respect of prior years	5.9	(0.8)
Impact of tax rate change	(5.7)	(5.8)
Deferred tax for the year	58.9	48.2
Income tax expense for the year	149.9	93.5

* Comparative figures have been restated to reflect continuing operations only (refer to Note 28).

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

27 INCOME TAX ON CONTINUING OPERATIONS *continued*

The tax charge on profit on ordinary activities for the year varied from the standard rate of UK Corporation Tax applicable to group companies as follows:

	2018 £m	2017 Restated* £m
Corporation Tax at 19% (2017 19.25%)	147.8	100.5
Adjustments in respect of prior years	(0.9)	(4.4)
Impact of tax rate change	(5.7)	(5.8)
Non-deductible expenses and other permanent differences	8.7	3.2
Income tax expense for the year	149.9	93.5

* Comparative figures have been restated to reflect continuing operations only (refer to Note 28).

Legislation has been enacted to reduce the rate of UK Corporation Tax from 19% to 17% on 1 April 2020. This reduces the tax rates expected to apply when temporary differences reverse and impacts the deferred tax charge.

	2018 £m	2017 £m
Comparison of UK Corporation Tax charge and payments		
UK Corporation Tax charge on profits for the year for continuing and discontinued operations	105.0	48.2
UK Corporation Tax in the consolidated cash flow statement for continuing and discontinued operations	40.7	37.5

The amount of Corporation Tax paid in the year, shown in the consolidated cash flow statements, and the amount of the Corporation Tax charge for the year are not the same. The main reason for this is the timing of payments. UK Corporation Tax is due in four instalments: two in the year to which the instalment relates, and two in the following year. In addition, the amount in the cash flow statement also includes any refunds received or payments made relating to Corporation Tax liabilities of prior periods.

28 DISCONTINUED OPERATIONS

On 16 October 2018, the group agreed to sell ScottishPower Generation Limited and its wholly owned subsidiary, SMW Limited to Drax Smart Generation HoldCo Limited which includes the sale of four CCGT power stations as well as pumped storage and hydro assets. The sale completed on 31 December 2018.

The Generation group was not previously classified as held-for-sale or as a discontinued operation. The comparative consolidated income statement and the consolidated statement of comprehensive income have been re-presented to show the discontinued operation separately from continuing operations.

All intra-group transactions have been fully eliminated in the consolidated financial results. The group has elected to attribute the elimination of transactions between the continuing operations and the discontinued operation before the disposal in a way that reflects the continuance of these transactions subsequent to the disposal, because the group believes this is useful to the users of the financial statements.

(a) Results from discontinued operations

	2018 £m	2017 £m
Revenue	524.7	617.1
Procurements	(406.5)	(533.3)
GROSS MARGIN	118.2	83.8
NET OPERATING EXPENSES	(25.9)	(28.6)
Net personnel expenses	(19.4)	(22.2)
Staff costs	(20.8)	(23.2)
Capital staff costs	1.4	1.0
Net external expenses	(6.5)	(6.4)
External services	(30.2)	(30.6)
Other operating income	23.7	24.2
Taxes other than income tax	(10.3)	(10.8)
GROSS OPERATING PROFIT	82.0	44.4
Impairment credit on trade and other receivables	0.2	–
Depreciation and amortisation charge, allowance and provisions	(47.1)	(43.2)
OPERATING PROFIT	35.1	1.2
Gain on sale of discontinued operations	155.8	0.1
Income tax on gain on sale of discontinued operations – net of transaction costs	–	–
Finance income	0.4	–
Finance costs	(5.0)	(6.7)
PROFIT/(LOSS) BEFORE TAX	186.3	(5.4)
Income tax	4.5	3.1
PROFIT/(LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX	190.8	(2.3)

(i) The profit/(loss) from the discontinued operations is attributable entirely to the owners of the company.

(b) Cash flows from discontinued operations

	2018 £m	2017 £m
Net cash flows from operating activities	53.0	59.6
Net cash flows from investing activities	705.8	(19.1)
Net cash flows from financing activities	(71.9)	(40.5)
Net cash flows for the year	686.9	–

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

28 DISCONTINUED OPERATIONS *continued*

(c) Effect of disposal on the financial position of the group

	Notes to the Accounts	Total £m
Book value of assets and liabilities at 31 December 2018		
Intangible assets	6	0.5
Property, plant and equipment	7	583.9
Inventories		27.3
Trade and other receivables		62.3
Deferred tax liabilities	20	(43.3)
Trade and other payables (including current tax liabilities)		(59.2)
Deferred income	15	(0.4)
Provisions	17	(39.9)
Retirement benefit obligations	16	(4.8)
Loans and other borrowings		(8.6)
Book value of assets and liabilities disposed		517.8
Total consideration (including deferred consideration of £2.3 million)		689.2
Gain on disposal		171.4
Realisation of revaluation reserve		5.7
Less transaction costs		(21.3)
Gain on sale of discontinued operations		155.8
The analysis of cash flow in respect of the above disposal is detailed below:		
		£m
Cash consideration (excluding deferred consideration)		686.9
Net cash and cash equivalents disposed		–
Net proceeds from disposal of subsidiaries		686.9

29 DIVIDENDS

	2018 pence per ordinary share	2017 pence per ordinary share	2018 £m	2017 £m
Interim dividend paid	12.8	6.8	563.2	300.0

30 CONTINGENT ASSET AND CONTINGENT LIABILITIES

As noted on page 6 of the Strategic Report, the 2018/19 Capacity Market is suspended pending the necessary State Aid approval. No income has been recognised by the group in relation to the 2018/19 scheme which commenced in October 2018. However, given there is a reasonable expectation that the Capacity Market will be re-introduced, the receipt of income for 2018 totalling £11.7 million is deemed probable and therefore considered to be a contingent asset as at 31 December 2018.

As noted on page 1 of the Strategic Report, on 16 October 2018, the group agreed to sell its Generation group to Drax; this sale completed on 31 December 2018. Following the suspension of the Capacity Market, a Deed of Amendment to the sale contract was agreed which provides for Drax to receive additional payments from the group (up to a maximum of £26 million) in relation to any lost Capacity Market income in the period from 1 January 2019 to 30 September 2019. Given there is a reasonable expectation that the Capacity Market will be re-introduced, but uncertainty around the timing and values, the outflow of economic benefit is only possible under the Deed of Amendment and so no position is recorded in the consolidated Accounts. As at 31 December 2018, a contingent liability is noted in the range of zero to £26 million.

Legal proceedings

In addition, the group's businesses are parties to various other legal claims, actions and complaints, certain of which may involve material amounts. ScottishPower 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 group currently believes that disposition of these matters will not have a materially adverse effect on the consolidated Accounts.

31 FINANCIAL COMMITMENTS

Contractual commitments

The group manages its energy resource requirements by integrating long-term firm, short-term and spot market purchases with its own generating resources to manage volume and price volatility and maximise value across the energy value chain. As part of its energy resource portfolio the group is committed under long-term purchase contracts summarised in the tables below.

	2018						Total £m
	2019 £m	2020 £m	2021 £m	2022 £m	2023 £m	2024 and thereafter £m	
Long-term energy purchase contract commitments	3,854.8	717.4	111.0	3.4	–	–	4,686.6
Other contractual commitments	334.2	78.0	17.0	10.1	9.2	59.8	508.3

	2017						Total £m
	2018 £m	2019 £m	2020 £m	2021 £m	2022 £m	2023 and thereafter £m	
Long-term energy purchase contract commitments	3,711.0	616.7	59.9	4.5	–	–	4,392.1
Other contractual commitments	363.4	191.9	72.8	16.5	8.9	63.7	717.2

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

32 RELATED PARTY TRANSACTIONS

(a) Transactions and balances arising in the normal course of business

	2018				2017			
	Ultimate parent (Iberdrola, S.A.) £m	Immediate parent Scottish Power Limited) £m	Other Iberdrola group companies £m	Jointly controlled entities £m	Ultimate parent (Iberdrola, S.A.) £m	Immediate parent Scottish Power Limited) £m	Other Iberdrola group companies £m	Jointly controlled entities £m
Types of transaction								
Sales and rendering of services	0.2	1.3	71.1	3.6	0.5	1.5	72.1	3.6
Purchases and receipt of services	(45.4)	(1.0)	(119.9)	(12.6)	(37.7)	(1.1)	(127.9)	(11.6)
Interest income	–	8.1	–	0.2	–	9.5	–	0.1
Interest costs (excluding ECLs)	(0.9)	(75.3)	–	–	(1.4)	(60.7)	(4.4)	–
Net (losses)/gains on foreign exchange	(1.1)	1.1	–	0.3	(3.8)	3.8	–	–
Net losses on financing derivatives	(0.2)	(1.0)	–	–	–	(0.8)	–	–
Dividends paid	–	(563.2)	–	–	–	(300.0)	–	–
Changes in the value of cash flow hedges	–	2.3	–	–	–	(21.0)	–	–
ECL recognised in respect of								
Trade and other receivables*	–	–	–	–	–	–	–	–
Loans and interest receivable	–	0.1	–	–	–	–	–	–
Balances outstanding								
Loans receivable	–	451.9	–	–	–	565.7	–	–
Trade and other receivables	–	–	4.4	6.0	–	–	8.6	5.3
Interest receivable	–	8.1	–	–	–	9.6	–	–
Derivative financial assets	–	5.2	0.7	–	–	8.2	1.8	–
Loans payable	(67.7)	(4,240.7)	–	(3.0)	(85.4)	(3,769.9)	–	–
Trade and other payables	–	(0.2)	(9.7)	(5.4)	–	(1.1)	(7.7)	(3.4)
Capital payables	–	–	(1.8)	–	–	–	(2.1)	–
Interest payable	(0.1)	(42.7)	–	–	(0.2)	(59.3)	–	–
Derivative financial liabilities	–	(0.6)	(1.6)	–	–	(5.3)	(0.4)	–
ECL on								
Trade and other receivables*	–	–	–	–	–	–	–	–
Loans and interest receivable	–	(0.2)	–	–	–	–	–	–

* The ECL in respect of balances with Iberdrola group companies is less than £0.1 million.

(i) The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received in relation to inter-group transactions.

(b) Remuneration of key management personnel

The remuneration of the key management personnel of the group is set out below. The remuneration of all 14 (2017 twelve) key management personnel is included within staff costs at Note 22(a).

	2018 £m	2017 £m
Short-term employee benefits	4.2	3.6
Post-employment benefits	0.8	0.4
Termination benefits	0.3	–
Share-based payments	2.4	2.3
	7.7	6.3

(c) Directors' remuneration

The remuneration of the directors who provided qualifying services to the group is set out below. During the year, all (2017 all) directors were remunerated by the group.

	2018 £000	2017 £000
Aggregate remuneration in respect of qualifying services	842	828
Number of directors who exercised share options	3	3
Number of directors who received shares under a long-term incentive scheme	2	2
Number of directors accruing retirement benefits under a defined benefit scheme	3	3
Highest paid director		
Aggregate remuneration	340	336
Accrued pension benefit	56	53

(i) The highest paid director received a benefit under a long-term share incentive scheme in both years.

(ii) The highest paid director exercised share options in both years.

(d) Ultimate and immediate parent company

The directors regard Iberdrola, S.A. (incorporated in Spain) as the ultimate parent company, which is also the parent company of the largest group in which the results of the company are consolidated. Copies of the consolidated Accounts of Iberdrola, S.A. may be obtained from the registered office of the company at Iberdrola, S.A., Torre Iberdrola, Plaza Euskadi 5, 48009, Bilbao, Spain.

The parent company of the smallest group in which the results of the company are consolidated is Scottish Power Limited. Copies of the Consolidated Accounts of Scottish Power Limited may be obtained from its registered address, 320 St. Vincent Street, Glasgow, G2 5AD.

In addition to the company's parent undertakings disclosed above, the group's other related undertakings are disclosed in Note 5.

NOTES TO THE CONSOLIDATED ACCOUNTS *continued*

31 December 2018

33 AUDITOR REMUNERATION

	2018 £m	2017 £m
Audit of the company and consolidated annual Accounts	0.1	0.1
Audit of the company's subsidiaries pursuant to legislation	0.8	0.8
Audit fees	0.9	0.9
Audit-related assurance services	0.2	0.1
Total	1.1	1.0

(a) For the year ended 31 December 2018, all fees paid to the group's auditors of £1.1 million (2017 £1.0 million) were charged to the income statement. £0.4 million of additional fees were also paid in respect of the 2017 audit in 2018.

34 GROUP RESTRUCTURING

As part of an Iberdrola group restructuring exercise, the following transactions took place during 2017.

- On 1 August 2017 Iberdrola Renovables France SAS was sold to Iberdrola Eólica Marina, S.A.U. (an indirectly wholly-owned subsidiary of Iberdrola, S.A.) for €24.4 million (equivalent to £21.8 million). Iberdrola Renovables France SAS has a 70% equity holding in one subsidiary, Ailes Marines SAS. As these companies' operations and net assets were not material to the group, they were not disclosed separately as discontinued operations, as defined in IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations'. The impact of the disposal of these companies on the results and net assets of the group is set out below.
- On 1 August 2017 Iberdrola Renovables Deutschland GmbH was sold to Iberdrola Eólica Marina, S.A.U. for €1 (equivalent to £1). Iberdrola Renovables Deutschland GmbH wholly owns two subsidiaries: Iberdrola Renovables Offshore Deutschland GmbH and Baltic Eagle GmbH (which was acquired during 2017). As these companies' operations and net assets were not material to the group they were not disclosed separately as discontinued operations, as defined in IFRS 5. The impact of the disposal of these companies on the results and net assets of the group is set out below.

Based on the book values of the net assets disposed of, the related proceeds and the effect of recycling of foreign exchange, the gain on disposal attributable to equity holders of the parent is £20.2 million, as summarised below:

	Notes to the Accounts	Total £m
Book values of assets and liabilities at 1 August 2017		
Intangible assets	6	0.4
Property, plant and equipment	7	1,143.5
Deferred tax	20	6.0
Trade and other receivables		8.1
Cash		1.5
Trade and other payables		(271.6)
Current payables due to Iberdrola group companies – loans		(311.1)
Non-current payables due to Iberdrola group companies – loans		(562.4)
Loans and other borrowings		(12.4)
Book value of assets disposed		2.0
Sales proceeds:		
Cash consideration		21.8
Gain on disposal before recycling of foreign exchange (including non-controlling interest)		19.8
Less non-controlling interest		(0.1)
Recycling of foreign exchange		0.5
Gain on disposal attributable to equity holders of the parent		20.2
The analysis of cash flow in respect of the above disposal is detailed below:		
		£m
Cash consideration		21.8
Net cash and cash equivalents disposed		(1.5)
Cash inflows on group restructuring (included in cash flows from investing activities)		20.3

35 GOING CONCERN

The group's business activities, together with the factors likely to affect its future development and position, are set out in the Strategic Report on pages 1 to 13.

The group has recorded a profit after tax in both the current and previous financial years and the group's balance sheet shows that it has net current liabilities of £2,300.6 million and net assets of £5,955.1 million at its most recent balance sheet date.

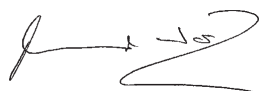
The group is ultimately owned by Iberdrola, S.A. and it participates in the Iberdrola group's centralised treasury arrangements and shares banking facilities with its parent companies and fellow subsidiaries. As a consequence, the group depends, in part, on the ability of the Iberdrola group to continue as a going concern. The directors have considered the group's funding relationship with Iberdrola to date and have considered available relevant information relating to Iberdrola's ability to continue as a going concern. In addition, the directors have no reason to believe that the Iberdrola group does not have the ability to and will not continue to fund the group to enable it to continue in operational existence.

On the basis of these considerations, the directors have a reasonable expectation that the group will be able to continue in operational existence for the foreseeable future. Therefore, they adopt the going concern basis of accounting in preparing the Accounts.

SCOTTISH POWER UK PLC
COMPANY BALANCE SHEET
at 31 December 2018

	Notes	2018 £m	2017 £m
ASSETS			
NON-CURRENT ASSETS			
Intangible assets	36	21.8	19.0
Property, plant and equipment		53.7	51.3
Property, plant and equipment in use	37	53.0	50.6
Property, plant and equipment in the course of construction	37	0.7	0.7
Trade and other receivables	38	2,104.6	2,497.4
Financial assets		3,815.5	3,395.3
Investments in subsidiaries	39	3,763.8	3,351.6
Other investments	39	0.6	0.6
Derivative financial instruments	40	51.1	43.1
Deferred tax asset	41	93.0	104.1
NON-CURRENT ASSETS		6,088.6	6,067.1
CURRENT ASSETS			
Trade and other receivables	38	877.8	318.5
Current tax asset		18.7	23.3
Financial assets		1.1	1.1
Derivative financial instruments	40	1.1	1.1
CURRENT ASSETS		897.6	342.9
TOTAL ASSETS		6,986.2	6,410.0
EQUITY AND LIABILITIES			
EQUITY			
Of shareholders of the parent		3,866.7	3,511.8
Share capital	42, 43	2,192.0	2,192.0
Share premium	43	398.2	398.2
Hedge reserve	43	0.2	0.1
Other reserves	43	420.4	8.2
Retained earnings – opening balance	43	913.3	1,053.6
Retained earnings – adjustment on initial application of IFRS 9	43	(1.8)	–
Retained earnings – profit for the year	43	547.6	346.2
Retained earnings – other movements	43	(603.2)	(486.5)
Retained earnings – closing balance	43	855.9	913.3
TOTAL EQUITY		3,866.7	3,511.8
NON-CURRENT LIABILITIES			
Provisions		516.0	569.2
Provision for retirement benefit obligations	44	512.7	564.8
Other provisions	45	3.3	4.4
Bank borrowings and other financial liabilities		1,093.7	1,074.9
Loans and other borrowings	46	1,093.7	1,074.9
Trade and other payables	47	86.4	69.5
NON-CURRENT LIABILITIES		1,696.1	1,713.6
CURRENT LIABILITIES			
Provisions	45	2.4	3.3
Bank borrowings and other financial liabilities		1,327.7	1,088.2
Loans and other borrowings	46	1,327.7	1,088.2
Trade and other payables	47	93.3	93.1
CURRENT LIABILITIES		1,423.4	1,184.6
TOTAL LIABILITIES		3,119.5	2,898.2
TOTAL EQUITY AND LIABILITIES		6,986.2	6,410.0

Authorised for issue by the board and signed on its behalf on 29 April 2019:



David Wark
Director

Notes 1 to 3, 5 and 9 and the accompanying Notes 36 to 54 are an integral part of the company balance sheet as at 31 December 2018.

SCOTTISH POWER UK PLC
COMPANY STATEMENT OF COMPREHENSIVE INCOME
for the year ended 31 December 2018

	Note	2018 £m	2017 £m
NET PROFIT FOR THE YEAR		547.6	346.2
OTHER COMPREHENSIVE INCOME			
Items that will not be reclassified to the income statement:			
Actuarial losses on retirement benefits:			
Actuarial losses on retirement benefits	43	(48.2)	(222.9)
Tax relating to actuarial losses on retirement benefits	43	8.2	36.4
Cash flow hedges:			
Change in the value of cash flow hedges	43	0.1	(0.1)
Tax relating to cash flow hedges	43	–	0.1
OTHER COMPREHENSIVE INCOME FOR THE YEAR		(39.9)	(186.5)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		507.7	159.7

Total comprehensive income for both years is wholly attributable to the equity holder of Scottish Power UK plc.

COMPANY STATEMENT OF CHANGES IN EQUITY
for the year ended 31 December 2018

	Share capital £m	Share premium £m	Hedge reserve £m	Other reserves £m	Retained earnings £m	Total equity £m
At 1 January 2017	872.0	398.2	0.1	8.2	1,053.6	2,332.1
Total comprehensive income for the year	–	–	–	–	159.7	159.7
Share capital issued	1,320.0	–	–	–	–	1,320.0
Dividends	–	–	–	–	(300.0)	(300.0)
At 1 January 2018	2,192.0	398.2	0.1	8.2	913.3	3,511.8
Adjustments due to IFRS 9	–	–	–	–	(1.8)	(1.8)
Adjusted balance at 1 January 2018	2,192.0	398.2	0.1	8.2	911.5	3,510.0
Total comprehensive income for the year	–	–	0.1	–	507.6	507.7
Capital contribution	–	–	–	412.2	–	412.2
Dividends	–	–	–	–	(563.2)	(563.2)
At 31 December 2018	2,192.0	398.2	0.2	420.4	855.9	3,866.7

Notes 1 to 3, 5 and 9 and the accompanying Notes 36 to 54 are an integral part of the company statement of comprehensive income and the company statement of changes in equity for the year ended 31 December 2018.

SCOTTISH POWER UK PLC
COMPANY CASH FLOW STATEMENT
for the year ended 31 December 2018

	2018 £m	2017 £m
Cash flows from operating activities		
Profit before tax	543.9	337.3
Adjustments for:		
Depreciation and amortisation	20.1	19.2
Change in provisions	2.2	1.6
Finance income and costs	25.0	29.6
Shareholding income	(563.2)	(378.5)
Net gain on disposal of non-current assets	(0.1)	–
Movement in retirement benefits	(112.4)	(110.0)
Changes in working capital:		
Change in trade and other receivables	(12.0)	8.5
Change in trade and other payables	20.7	(11.6)
Provisions paid	(4.4)	(2.5)
Income taxes received	28.0	21.4
Interest received	72.6	69.3
Dividends received	563.2	378.5
Net cash flows from operating activities (i)	583.6	362.8
Cash flows from investing activities		
Investments in intangible assets	(12.7)	(9.5)
Investments in property, plant and equipment	(11.1)	(12.3)
Proceeds from disposal of property, plant and equipment	0.1	0.1
Net investment in non-current investments	–	(150.8)
(Increase)/decrease in amounts due from Iberdrola group companies – current loans receivable	(564.9)	375.6
Decrease/(increase) in amounts due from Iberdrola group companies – non-current loans receivable	406.0	(758.0)
Net cash flows from investing activities (ii)	(182.6)	(554.9)
Cash flows from financing activities		
Increase/(decrease) in amounts due to Iberdrola group companies – current loans payable	235.4	(531.2)
Dividends paid to company's equity holder	(563.2)	(300.0)
Share capital issued	–	1,320.0
Interest paid	(77.4)	(90.4)
Cash inflows from issuance/(repayments) of borrowings	4.2	(206.3)
Net cash flows from financing activities (iii)	(401.0)	192.1
Net cash and cash equivalents (i)+(ii)+(iii)	–	–
Cash and cash equivalents at beginning of year	–	–
Cash and cash equivalents at end of year	–	–

Notes 1 to 3, 5 and 9 and the accompanying Notes 36 to 54 are an integral part of the company cash flow statement for the year ended 31 December 2018.

NOTES TO THE COMPANY ACCOUNTS

31 December 2018

36 INTANGIBLE ASSETS

Year ended 31 December 2017	Computer software (Note (a)) £m	Licences £m	Total £m
Cost:			
At 1 January 2017	84.2	1.1	85.3
Additions	9.5	–	9.5
Disposals	(0.6)	–	(0.6)
At 31 December 2017	93.1	1.1	94.2
Amortisation:			
At 1 January 2017	65.0	0.6	65.6
Amortisation for the year	9.8	0.4	10.2
Disposals	(0.6)	–	(0.6)
At 31 December 2017	74.2	1.0	75.2
Net book value:			
At 31 December 2017	18.9	0.1	19.0
At 1 January 2017	19.2	0.5	19.7

Year ended 31 December 2018	Computer software (Note (a)) £m	Licences £m	Total £m
Cost:			
At 1 January 2018	93.1	1.1	94.2
Additions	7.3	5.4	12.7
Disposals	(3.5)	–	(3.5)
At 31 December 2018	96.9	6.5	103.4
Amortisation:			
At 1 January 2018	74.2	1.0	75.2
Amortisation for the year	9.0	0.9	9.9
Disposals	(3.5)	–	(3.5)
At 31 December 2018	79.7	1.9	81.6
Net book value:			
At 31 December 2018	17.2	4.6	21.8
At 1 January 2018	18.9	0.1	19.0

(a) The cost of fully amortised computer software still in use at 31 December 2018 was £61.9 million (2017 £52.3 million).

NOTES TO THE COMPANY ACCOUNTS *continued*

31 December 2018

37 PROPERTY, PLANT AND EQUIPMENT

(a) Movements in property, plant and equipment

	Property, plant and equipment in use (Note (ii)) £m	Plant in progress (Note (iii)) £m	Total £m
Year ended 31 December 2017			
Cost:			
At 1 January 2017	89.3	1.8	91.1
Additions	10.7	2.2	12.9
Transfers from progress to plant in use	3.3	(3.3)	–
Disposals	(9.2)	–	(9.2)
At 31 December 2017	94.1	0.7	94.8
Depreciation:			
At 1 January 2017	43.6	–	43.6
Charge for the year	9.0	–	9.0
Disposals	(9.1)	–	(9.1)
At 31 December 2017	43.5	–	43.5
Net book value:			
At 31 December 2017	50.6	0.7	51.3
At 1 January 2017	45.7	1.8	47.5
The net book value of property, plant and equipment at 31 December 2017 is analysed as follows:			
Property, plant and equipment in use	50.6	–	50.6
Property, plant and equipment in the course of construction	–	0.7	0.7
	50.6	0.7	51.3

	Property, plant and equipment in use (Note (ii)) £m	Plant in progress (Note (iii)) £m	Total £m
Year ended 31 December 2018			
Cost:			
At 1 January 2018	94.1	0.7	94.8
Additions	12.6	–	12.6
Disposals	(4.6)	–	(4.6)
At 31 December 2018	102.1	0.7	102.8
Depreciation:			
At 1 January 2018	43.5	–	43.5
Charge for the year	10.2	–	10.2
Disposals	(4.6)	–	(4.6)
At 31 December 2018	49.1	–	49.1
Net book value:			
At 31 December 2018	53.0	0.7	53.7
At 1 January 2018	50.6	0.7	51.3
The net book value of property, plant and equipment at 31 December 2018 is analysed as follows:			
Property, plant and equipment in use	53.0	–	53.0
Property, plant and equipment in the course of construction	–	0.7	0.7
	53.0	0.7	53.7

(i) The 'Property, plant and equipment in use' category principally comprises fixtures and fittings and IT equipment.

(ii) The 'Plant in progress' category comprises costs in relation to smart meter infrastructure.

(iii) The cost of fully depreciated property, plant and equipment still in use at 31 December 2018 was £24.5 million (2017 £24.4 million).

NOTES TO THE COMPANY ACCOUNTS *continued*

31 December 2018

37 PROPERTY, PLANT AND EQUIPMENT *continued*

(b) Operating lease arrangements

	2018 £m	2017 £m
(i) Operating lease commitments		
The future minimum discounted lease payments under non-cancellable operating leases are as follows:		
Within one year	10.9	13.5
Between one and five years	33.4	35.4
More than five years	83.7	88.0
	128.0	136.9

The company leases various property, plant and equipment under non-cancellable operating lease arrangements. The leases have varying terms, escalation clauses and renewal rights.

(ii) Operating lease receivables

	2018 £m	2017 £m
The future minimum discounted lease payments receivable under non-cancellable operating leases are as follows:		
Within one year	0.8	0.8
Between one and five years	0.8	0.9
	1.6	1.7

The company leases buildings as a lessor under operating leases. The lease arrangements have varying terms and some contain provisions to extend the term at the option of the lessee. The leases have varying terms, escalation clauses and renewal rights.

(c) Capital commitments

	2018 £m	2017 £m
Contracted but not provided	0.1	0.3

38 TRADE AND OTHER RECEIVABLES

	Notes	2018 £m	2017 £m
Current receivables:			
Receivables due from Iberdrola group companies – trade		7.0	10.7
Receivables due from Iberdrola group companies – loans	(a), (b)	823.6	259.2
Receivables due from Iberdrola group companies – interest		26.1	28.4
Trade receivables		11.7	10.7
Prepayments		9.4	9.5
		877.8	318.5
Non-current receivables:			
Receivables due from Iberdrola group companies – loans	(a), (b)	2,044.6	2,452.0
Prepayments		4.1	6.3
Other receivables	(c)	55.9	39.1
		2,104.6	2,497.4

(a) An ECL has been calculated on all loans receivable (Refer to Note 40).

(b) Current loans due from Iberdrola group companies includes £418.2 million (2017 £67.2 million) repayable on demand with interest payable at 1% above the Bank of England base rate. The non-current loans with Iberdrola group companies due to mature in 2022, 2023, 2025 and 2027 are repayable in equal instalments on a bi-annual basis. The instalment of £192.0 million due in 2018 on the loans with a final maturity of 2022 was classified as current at 31 December 2017 and the instalments of £406.0 million due in 2019 on the loans with final maturity dates of 2023, 2025 and 2027 were classified as current at 31 December 2018.

(c) This balance represents other receivables recognised as part of a contractual renegotiation.

(d) Information about the company's exposure to credit and market risks and impairment losses for Trade and other receivables are included in Note 9 (e).

NOTES TO THE COMPANY ACCOUNTS *continued*

31 December 2018

39 INVESTMENTS

	Notes	Investments in subsidiaries £m	Other investments (Note (a)) £m	Total £m
At 1 January 2017		3,200.7	0.7	3,201.4
Additions	(b)	160.0	–	160.0
Disposals	(c)	(9.1)	(0.1)	(9.2)
At 1 January 2018		3,351.6	0.6	3,352.2
Additions	(d)	412.2	–	412.2
At 31 December 2018		3,763.8	0.6	3,764.4

- (a) At 31 December 2018 the company held £0.6 million (2017 £0.6 million) of investments for which no quoted market price is available and whose fair value could not be reliably measured.
- (b) On 11 December 2017, the company subscribed for and was allotted an additional 160,000,000 ordinary shares of £1 each in Scottish Power Renewables (UK) Limited for a consideration of £160.0 million.
- (c) During 2017, certain of the company's dormant subsidiaries were dissolved resulting in the write-off of £9.1 million of investments.
- (d) On 28 June 2018, Scottish Power Limited approved a loan waiver totalling £412.2 million with the company's indirect subsidiary ScottishPower Generation Limited. This has been treated as a capital contribution and the company has therefore recognised this as an additional investment of £412.2 million.
- (e) The company's subsidiary and joint venture holdings are listed in Note 5.

40 FINANCIAL INSTRUMENTS

The effect of initially applying IFRS 9 on the company's Accounts is detailed in Note 2A3.2. Due to the transition method chosen, comparative information has not been presented to reflect the new requirements.

(a) Carrying value of financial instruments

The table below sets out the carrying amount and fair value of the company's financial instrument that are within the scope of IFRS 9.

	Notes	2018			2017		
		Carrying amount £m	Fair value £m	Classification under IFRS 9	Carrying amount £m	Fair value £m	Classification under IAS 39
Financial assets							
Derivative financial instruments	(i)	52.2	52.2	Fair value hedging instrument	44.2	44.2	Fair value hedging instrument
Receivables	(ii), (iii)	2,968.9	3,186.7	Amortised cost	2,800.1	3,090.7	Loans and Receivables
Other investments		0.6	0.6	FVTPL	0.6	0.6	Available for sale
Financial liabilities							
Loans and other borrowings	(iii)	(2,421.4)	(2,614.9)	Amortised cost	(2,163.1)	(2,415.6)	Amortised cost
Payables	(ii)	(147.9)	(147.9)	Amortised cost	(123.5)	(123.5)	Amortised cost

The carrying amount of these financial instruments is calculated as set out in Note 3H. With the exception of receivables and loans and other borrowings, the carrying value of financial instruments is a reasonable approximation of fair value. The fair values of receivables and loans and other borrowings are calculated as set out below in footnote (iii).

- (i) Further detail on derivative financial instruments is disclosed in Note 40(c).
- (ii) Balances outwith the scope of IFRS 7 and IFRS 9 have been excluded, namely prepayments, other taxes and social security and payments received on account.
- (iii) The fair values of receivables and loans and other borrowings are calculated using the most recently traded price to the year end date where available, or alternatively a discounted cash flow.

(b) Measurements of financial instruments

The company holds certain financial instruments which are measured in the balance sheet at fair value. The company uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities.
- Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly.
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

In both the current and the prior year, all other investments held by the company are classified as Level 1. In both the current and prior year all derivatives held by the company are Level 2. Level 2 foreign exchange derivatives comprise cross currency swaps and forward foreign exchange contracts which are fair valued using forward exchange rates that are quoted in an active market. There were no transfers between levels of the fair value hierarchy in the current or prior year.

NOTES TO THE COMPANY ACCOUNTS *continued*

31 December 2018

40 FINANCIAL INSTRUMENTS *continued*

(c) Analysis of derivative financial instruments - carrying value

		2018		2017	
		Assets			
	Notes	Current £m	Non- current £m	Current £m	Non- current £m
Hedging derivatives: Exchange rate hedges					
Fair value hedge – Currency swap	(i), (ii)	1.0	51.0	1.1	43.1
Cash flow – Foreign exchange	(i)	0.1	0.1	–	–
Total derivatives in the balance sheet		1.1	51.1	1.1	43.1

(i) The company enters into forward foreign exchange contracts to hedge foreign currency risk on retranslation of foreign currency payables. The company enters into foreign currency swaps to hedge foreign currency risk on the retranslation of the 10 billion JPY loan.

(ii) At 31 December 2018 the company held cash collateral of £48.2 million (2017 £44.0 million) in respect of derivatives.

(d) Financial risk management

For details of the company's financial risk management processes (covering credit risk and treasury risk) refer to Note 9(e).

(i) Credit risk

The company uses the simplified model to measure ECLs for trade receivables. The provision rates represent a lifetime ECL and are based on the Iberdrola group's historical loss experience and default rates.

The table below illustrates the ECL on trade receivables:

	Ageing of trade receivables		
	0-6 months £m	Greater than 6 months £m	Total £m
As at 31 December 2018			
Weighted Average Expected Loss Rate (%)	–	4.9%	2.5%
Gross carrying value	5.9	6.1	12.0
Loss allowance	–	(0.3)	(0.3)
Net Carrying Amount	5.9	5.8	11.7
As at 1 January 2018			
Weighted Average Expected Loss Rate (%)	–	6.0%	2.7%
Gross carrying value	6.0	5.0	11.0
Loss allowance	–	(0.3)	(0.3)
Net Carrying Amount	6.0	4.7	10.7

Trade receivables are written off when there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, amongst others, the failure of a debtor to engage in a repayment plan with the company.

Other receivables £55.9 million (2017 £39.1 million)

For other receivables the general ECL model is used. The loss allowance is measured at an amount equal to twelve month ECL. However, if the credit risk on that financial instrument has increased significantly since initial recognition, the loss allowance is measured at an amount equal to the lifetime ECL. Further detail on the general ECL model can be found in Note 9(e)(i).

Receivable due from Iberdrola group companies – trade £7.0 million (2017 £10.7 million)

The ECL on trade receivables due from Iberdrola group companies is calculated using the simplified model described above.

Loans and interest due from other Iberdrola group companies £2,894.3 million (2017 £2,739.6 million)

The company provides funding in the form of interest bearing on demand loans and interest bearing long-term loans to other Iberdrola group companies. Credit risk from group companies is considered to be low, as the company is part of the Iberdrola group's centralised Treasury function and no group company has a credit rating lower than BBB+ (in line with Standard and Poor's external credit ratings). The ECL on loans due from other Iberdrola group companies is calculated using the general model and therefore a twelve month ECL is applied.

NOTES TO THE COMPANY ACCOUNTS *continued*

31 December 2018

40 FINANCIAL INSTRUMENTS *continued*

(d) Financial risk management *continued*

(i) Credit risk *continued*

The exposure to credit risk of loans to other Iberdrola group companies (including interest) held at amortised cost by credit rating are set out in the table below:

Credit Rating	As at 31 December 2018			As at 1 January 2018		
	Gross Carrying Value £m	ECL £m	Amortised Cost £m	Gross Carrying Value £m	ECL £m	Amortised Cost £m
BBB+	2,896.2	(1.9)	2,894.3	2,739.6	(2.0)	2,737.6

Reconciliation of opening to closing loss allowance

The closing loss allowances for all financial assets measured at amortised cost, as at 31 December 2018 reconciles to the opening loans to loss allowances as follows:

	ECL on total financial assets £m
Balance as at 31 December 2017 under IAS 39	0.3
Adjustment on initial application of IFRS 9	2.2
Balance as at 1 January 2018 under IFRS 9	2.5
Decrease in loss allowance recognised in the income statement	(0.1)
At 31 December 2018	2.4

The aggregate movement in the ECL from 1 January 2018 to 31 December 2018 is primarily due to the probability of default applied to loans to other Iberdrola group companies reducing by 0.01%.

(ii) Treasury risk

Treasury risk comprises liquidity risk (the risk the company has insufficient funds to meet its liabilities) and market risk (the risk of loss from changes in interest and foreign exchange rates). Refer to Note 9(e)(iii) for a detailed explanation of how the company manages Treasury risk.

Liquidity analysis – maturity profile of financial liabilities

The table below summarises the maturity profile of the company's financial liabilities based on contractual undiscounted cash flows.

		2018						
Cash outflows	Note	2019 £m	2020 £m	2021 £m	2022 £m	2023 £m	2024 and thereafter £m	Total £m
Loans and other borrowings	(a)	1,401.3	57.4	348.9	40.4	290.7	754.3	2,893.0
Payables		50.1	6.9	50.9	0.6	–	–	108.5
		1,451.4	64.3	399.8	41.0	290.7	754.3	3,001.5

		2017						
Cash outflows	Note	2018 £m	2019 £m	2020 £m	2021 £m	2022 £m	2023 and thereafter £m	Total £m
Loans and other borrowings	(a)	1,166.0	57.1	57.4	349.0	40.5	1,053.5	2,723.5
Payables		38.7	9.2	5.5	25.4	0.2	–	79.0
		1,204.7	66.3	62.9	374.4	40.7	1,053.5	2,802.5

(a) Contractual cash flows include accrued interest as these cash flows are included within loans and borrowings.

The interest payments on variable interest rate loans and bond issues in the table above reflect market forward interest rates at the reporting date and these amounts may change as market interest rates change.

Interest rate risk

The table below shows the debt structure of the company after taking derivatives into account.

	2018 £m	2017 £m
Fixed rate	697.8	697.0
Variable rate	1,723.6	1,466.1
	2,421.4	2,163.1

The company's borrowings are held at amortised cost. The reference interest rates for the floating rate borrowings are London Inter-Bank Offer Rate ("LIBOR"), Bank of England Base Rate ("Base") and Retail Prices Index ("RPI").

The variable rate debt consists of a £101.7 million (2017 £93.8 million) Japanese Yen ("JPY") loan, £293.3 million (2017 £283.3 million) inflation linked bonds, £48.2 million (2017 £44.0 million) LIBOR debt and £1,280.4 million (2017 £1,045.0 million) loans linked to Base.

Sensitivity analysis on the interest rate changes

The table overleaf illustrates the impact on the annual interest rate charge/(income) considering various rate changes. The analysis assumes all other factors remain constant.

NOTES TO THE COMPANY ACCOUNTS *continued*

31 December 2018

40 FINANCIAL INSTRUMENTS *continued*

(d) Financial risk management *continued*

(ii) Treasury risk *continued*

		Interest rate	Change in rate	Impact on interest rate charges/ (income) in 2018 £m	Impact on interest rate charges/ (income) in 2017 £m
Loans payable	JPY bond	(a)	+ 0.25%	0.1	0.1
			+ 0.50%	0.3	0.3
			- 0.25%	(0.1)	(0.1)
			- 0.50%	(0.3)	(0.3)
Loans payable	LIBOR debt	LIBOR	+ 0.25%	0.1	0.1
			+ 0.50%	0.2	0.2
			- 0.25%	(0.1)	(0.1)
			- 0.50%	(0.2)	(0.2)
Loans payable	Short-term variable rate debt	Base	+ 0.25%	3.2	2.6
			+ 0.50%	6.4	5.2
			- 0.25%	(3.2)	(2.6)
			- 0.50%	(6.4)	(5.2)
Loans payable	Inflation linked bonds	RPI	+ 0.25%	0.7	0.7
			+ 0.50%	1.5	1.4
			- 0.25%	(0.7)	(0.7)
			- 0.50%	(1.5)	(1.4)
Loans receivable	LIBOR debt	LIBOR	+ 0.25%	(3.2)	(3.2)
			+ 0.50%	(6.4)	(6.4)
			- 0.25%	3.2	3.2
			- 0.50%	6.4	6.4
Loans receivable	Short-term variable rate debt	Base	+ 0.25%	(1.0)	(0.2)
			+ 0.50%	(2.1)	(0.3)
			- 0.25%	1.0	0.2
			- 0.50%	2.1	0.3

(a) The interest on the JPY bond is fixed, however this is changed to variable by cross currency swap. Interest is based on the Sterling LIBOR curve.

Foreign currency risk: foreign exchange rate cash flow hedges

The company is subject to cash flow risk resulting from the purchase of various assets which are denominated in foreign currencies. The risk being hedged relates to the fluctuation in the functional currency terms of value of these foreign currency denominated purchases. The company enters into forward foreign exchange rate contracts to hedge those risks.

For an analysis of the split of the carrying value of foreign exchange contracts please refer to Note 40(c).

The amounts relating to foreign exchange rate derivatives designated as cash flow hedges during the year are detailed in the table below.

	Notes	Hedging derivatives 2018 £m	Hedging derivatives 2017 £m
Notional amount		9.7	1.9
Carrying amount – asset	(a)	0.2	–
Changes in the value of the hedging instrument recognised in OCI	(b)	(0.2)	0.2
Amounts reclassified from the cash flow hedge to balance sheet	(c)	–	(0.4)

(a) The carrying amount of derivative assets are recorded within Derivative financial instruments.

(b) This is consistent with the change in the fair value of the hedging instrument used to calculate ineffectiveness.

(c) The amount reclassified from the cash flow hedge reserve to the balance sheet is included within Property, plant and equipment in use £nil (2017 (£0.4) million).

The amounts at the reporting date relating to foreign exchange items designated as hedged items were as follows.

	Change in fair value used for calculating hedge ineffectiveness		Cash flow hedge reserve balance	
Line item in the financial statements in which the hedged item is included	2018 £m	2017 £m	2018 £m	2017 £m
Property, plant and equipment in use	0.2	(0.2)	0.2	0.1

The company determines that the economic relationship between the hedging instrument (the foreign exchange rate forward contract) and the hedged item (the asset purchase) will virtually always achieve 100% effectiveness. This is because the company compares movements in the fair value of the expected highly probable forecast foreign currency cash flows, with movements in the fair value of the expected changes in cash flows from the hedging instrument. Forecast future foreign currency cash flows are largely based upon contractual obligations.

Ineffectiveness will arise if the trade has been cancelled, in which case there would be no future transaction.

NOTES TO THE COMPANY ACCOUNTS *continued*

31 December 2018

40 FINANCIAL INSTRUMENTS *continued*

(d) Financial risk management *continued*

(ii) Treasury risk *continued*

Fair value hedges

Hedging the value of cross currency debt: the company has issued debt instruments denominated in JPY. The value of the company's liability with respect to those instruments is subject to foreign exchange risk and interest rate risk. As a result the company has entered into cross-currency swaps and has designated these within a fair value hedging relationship where they meet the required hedging criteria to mitigate this risk. The carrying value of the associated 10 billion JPY loan is £101.7 million (2017 £93.8 million).

	Notes	As at 31 December 2018	As at 31 December 2017
Notional amount (£m)		51.4	51.4
Carrying amount – asset (£m)	(a)	52.0	44.2
Change in fair value of the hedging instrument used in calculating hedge ineffectiveness (£m)		(2.5)	6.8
Change in fair value of hedged item used to calculate ineffectiveness (£m)	(b)	2.5	(6.8)
Hedge ratio		1:1	1:1
Hedge rate (£:JPY)		1:194.55	1:194.55

(a) The carrying value of the fair value currency swap is included within derivative financial instruments on the balance sheet.

(b) The change in value of hedged items used to calculate hedge ineffectiveness is included within loans and other borrowings.

Hedge assessment on foreign currency derivatives

Hedge assessment on foreign currency derivatives is done prospectively to verify that the forecast transactions are still highly probable of occurring (for cash flow hedges) as well as retrospectively, to assess the effectiveness in the period under review. Prospective assessment is performed using sensitivity analysis and critical terms matching.

Sensitivity analysis on foreign currency cash flows

No sensitivity analysis has been performed in relation to changes in foreign exchange rates as almost all foreign currency purchases and foreign currency debts are hedged. Therefore there is immaterial financial exposure. Any movement in the value of the hedged item would be compensated for by movement in the value of the hedging instrument.

41 DEFERRED TAX ASSET

Deferred tax recognised in the Accounts is as follows:

	Property, plant and equipment £m	Derivative financial instruments £m	Retirement benefits £m	Other temporary differences £m	Total £m
At 1 January 2017	3.2	(0.1)	82.1	0.2	85.4
Charge to income statement	(0.2)	–	(19.2)	1.6	(17.8)
Recorded in the statement of comprehensive income	–	0.1	36.4	–	36.5
At 1 January 2018	3.0	–	99.3	1.8	104.1
Adjustment due to IFRS 9	–	–	–	0.4	0.4
Adjusted balance at 1 January 2018	3.0	–	99.3	2.2	104.5
Charge to income statement	(0.5)	–	(19.1)	(0.1)	(19.7)
Recorded in the statement of comprehensive income	–	–	8.2	–	8.2
At 31 December 2018	2.5	–	88.4	2.1	93.0

(a) At 31 December 2018, the company had unutilised capital losses of £5.3 million (2017 £5.3 million). No deferred tax has been recognised in the Accounts due to the unpredictability of suitable future profit streams against which these losses may be utilised.

(b) Legislation has been enacted to reduce the rate of the UK Corporation Tax to 17% on 1 April 2020. This reduces the tax rates expected to apply when temporary differences reverse and impacts the deferred tax charge.

NOTES TO THE COMPANY ACCOUNTS *continued*

31 December 2018

42 SHARE CAPITAL

	2018 £m	2017 £m
Allotted, called up and fully paid:		
4,383,983,102 ordinary shares of 50p each (2017 4,383,983,102)	2,192.0	2,192.0

43 ANALYSIS OF MOVEMENTS IN EQUITY ATTRIBUTABLE TO THE EQUITY HOLDER OF SCOTTISH POWER UK PLC

	Share Capital (Note (a)) £m	Share premium (Note (b)) £m	Hedge reserve (Note (c)) £m	Other reserves (Note (d)) £m	Retained earnings (Note (e)) £m	Total £m
At 1 January 2017	872.0	398.2	0.1	8.2	1,053.6	2,332.1
Profit for the year attributable to the equity holder of Scottish Power UK plc	–	–	–	–	346.2	346.2
Share capital issued	1,320.0	–	–	–	–	1,320.0
Changes in the value of cash flow hedges	–	–	(0.1)	–	–	(0.1)
Tax relating to cash flow hedges	–	–	0.1	–	–	0.1
Actuarial losses on retirement benefits	–	–	–	–	(222.9)	(222.9)
Tax relating to actuarial losses on retirement benefits	–	–	–	–	36.4	36.4
Dividends	–	–	–	–	(300.0)	(300.0)
At 1 January 2018	2,192.0	398.2	0.1	8.2	913.3	3,511.8
Adjustments due to IFRS 9	–	–	–	–	(1.8)	(1.8)
Adjusted balance at 1 January 2018	2,192.0	398.2	0.1	8.2	911.5	3,510.0
Profit for the year attributable to the equity holder of Scottish Power UK plc	–	–	–	–	547.6	547.6
Changes in the value of cash flow hedges	–	–	0.1	–	–	0.1
Tax relating to cash flow hedges	–	–	–	–	–	–
Actuarial losses on retirement benefits	–	–	–	–	(48.2)	(48.2)
Tax relating to actuarial losses on retirement benefits	–	–	–	–	8.2	8.2
Capital contribution	–	–	–	412.2	–	412.2
Dividends	–	–	–	–	(563.2)	(563.2)
At 31 December 2018	2,192.0	398.2	0.2	420.4	855.9	3,866.7

- (a) On 5 October 2017, the company issued 2,640,000,000 ordinary shares of 50p each to its immediate parent, Scottish Power Limited, for a total consideration of £1,320.0 million.
- (b) The share premium account represents consideration received for shares issued in excess of their nominal amount.
- (c) The hedge reserve represents the balance of gains and losses on cash flow hedges (net of taxation) not yet transferred to income or the carrying value of a non-financial asset.
- (d) Other reserves as at 31 December 2018 comprises a capital redemption reserve of £8.2 million (2017 £8.2 million) and a capital contribution reserve of £412.2 million (2017 nil). The capital redemption reserve comprises the nominal value of the company's ordinary share capital purchased by the company in previous years. During the year, a capital contribution of £412.2 million was recognised following the waiver of an inter-company loan of £412.2 million by Scottish Power Limited, the group's parent company, to ScottishPower Generation Limited prior to its sale.
- (e) Retained earnings comprises the cumulative balance of profit and losses recognised in the financial statements as adjusted for transactions with shareholders, principally dividends.
- (f) The changes in the hedge reserve arising from valuation adjustments to the hedging derivatives are set out below:

	Foreign exchange rate hedges £m	Tax effect £m	Total £m
At 1 January 2017	0.2	(0.1)	0.1
Effective cash flow hedges recognised	0.3	–	0.3
Removed from equity and recognised in carrying amount of hedged items	(0.4)	0.1	(0.3)
At 1 January 2018	0.1	–	0.1
Effective cash flow hedges recognised	0.1	–	0.1
At 31 December 2018	0.2	–	0.2

- (g) All amounts included in the hedge reserve at 31 December 2018 are due to mature within one year (2017 due within one year).

NOTES TO THE COMPANY ACCOUNTS *continued*

31 December 2018

44 RETIREMENT BENEFIT OBLIGATIONS

The amounts recognised in the balance sheet in respect of retirement benefit obligations are detailed below:

	2018 £m	2017 £m
Non-current liabilities	512.7	564.8

- (a) The company recognises the pension scheme deficit in the balance sheet for the schemes for which it is the sponsoring employer as there is no appropriate contractual agreement or group policy to allocate the deficit on a legal entity basis. Detailed disclosures are provided in Note 16 of the group financial statements.

45 OTHER PROVISIONS

Year ended 31 December 2017	Notes	At 1 January 2017 £m	New provisions £m	Unwinding of discount £m	Utilised during year £m	At 31 December 2017 £m
Onerous contracts	(a)	7.3	0.2	0.2	(2.3)	5.4
Reorganisation and restructuring	(b)	–	1.4	–	–	1.4
Other	(c)	1.1	–	–	(0.2)	0.9
		8.4	1.6	0.2	(2.5)	7.7

Year ended 31 December 2018	Notes	At 1 January 2018 £m	New provisions £m	Unwinding of discount £m	Utilised during year £m	Released during year £m	At 31 December 2018 £m
Onerous contracts	(a)	5.4	–	0.2	(0.7)	(0.5)	4.4
Reorganisation and restructuring	(b)	1.4	2.9	–	(3.0)	–	1.3
Other	(c)	0.9	–	–	(0.7)	(0.2)	–
		7.7	2.9	0.2	(4.4)	(0.7)	5.7

Analysis of total other provisions

	2018 £m	2017 £m
Non-current	3.3	4.4
Current	2.4	3.3
	5.7	7.7

- (a) The provision for 'Onerous contracts' relates to various property leases. The leases will expire between 2019 and 2025.
 (b) The provision for 'Reorganisation and restructuring' relates to group wide restructuring programmes launched during 2017 and 2018 with the balance of both programmes expected to be utilised in 2019.
 (c) The 'Other' category comprised various provisions which were not individually sufficiently material to warrant separate disclosure.

46 LOANS AND OTHER BORROWINGS

Analysis by instrument and maturity	Notes	Interest rate*	Maturity	2018 £m	2017 £m
Loans with Iberdrola group companies		Base + 1%	On demand	1,280.4	1,045.0
Collateral		LIBOR	17 June 2019	48.2	44.0
£300 million medium-term note	(b)	5.9%	22 February 2021	298.5	297.9
£250 million euro-sterling bond	(c), (d)	6.75%	29 May 2023	249.3	249.1
£175 million inflation linked bond	(b)	3.494% x RPI	13 October 2024	293.3	283.3
10 billion JPY loan	(e)	4.6%	27 July 2029	101.7	93.8
£50 million medium-term note	(b)	5.75%	9 December 2039	50.0	50.0
£100 million medium-term note	(b)	6.375%	31 May 2041	100.0	100.0
				2,421.4	2,163.1

* Base – Bank of England Base Rate; LIBOR – London Inter-Bank Offer Rate; RPI – Retail Price Index

Analysis of loans and other borrowings

	Note	2018 £m	2017 £m
Non-current		1,093.7	1,074.9
Current	(a)	1,327.7	1,088.2
		2,421.4	2,163.1

- (a) Current borrowings comprise loans with Iberdrola group companies repayable on demand and collateral together with finance costs due to be amortised within one year, the short-term element of fair value hedge adjustments and the adjustments on discontinued fair value hedges due to be amortised within one year. This totalled £(0.9) million (2017 £(0.8) million).
 (b) Scottish Power Limited and the company have an established joint US\$7 billion euro medium-term note programme. Scottish Power Limited has not issued under the programme. The company has in issue various notes in Sterling, which can be redeemed by the company with 30 to 90 days' notice in case of unfavourable and unavoidable changes in the UK tax laws impacting on the note payments.
 (c) This bond contains a "Loss of licences" covenant that will require repayment of the outstanding amount should the UK group lose all its electricity licences (distribution, transmission and supply licences).
 (d) The euro-sterling bond due 2023 can be redeemed at any time by the company at the higher of the principal amount or redemption price (as determined by HSBC Bank plc) giving 30 to 45 days' notice to the lender.
 (e) The interest rate quoted above on the 10 billion JPY loan is fixed. This is changed to a variable rate by a cross currency swap.
 (f) The company has no undrawn committed borrowing facilities at 31 December 2018 (2017 nil).

NOTES TO THE COMPANY ACCOUNTS *continued*

31 December 2018

46 LOANS AND OTHER BORROWINGS *continued*

(g) Reconciliation of movements of liabilities to cash flows arising from financing activities

	Liabilities			Total £m
	Loans and other borrowings (Current) £m	Loans and other borrowings (Non-current) £m	Interest payable (Current) (Note (ii)) £m	
At 1 January 2017	1,824.3	1,076.5	57.7	2,958.5
Decrease in amounts due to Iberdrola group companies	(531.2)	–	–	(531.2)
Repayments of borrowings	(206.3)	–	–	(206.3)
Interest paid	–	–	(90.4)	(90.4)
Total movements from financing cash flows	(737.5)	–	(90.4)	(827.9)
Fair value and other non-cash movements	1.4	(1.6)	(20.3)	(20.5)
Other movements	–	–	97.5	97.5
Total liability-related other movements	1.4	(1.6)	77.2	77.0
At 31 December 2017	1,088.2	1,074.9	44.5	2,207.6

	Liabilities			Total £m
	Loans and other borrowings (Current) £m	Loans and other borrowings (Non-current) £m	Interest payable (Current) (Note (ii)) £m	
At 1 January 2018	1,088.2	1,074.9	44.5	2,207.6
Increase in amounts due to Iberdrola group companies	235.4	–	–	235.4
Cash inflows from borrowings	4.2	–	–	4.2
Interest paid	–	–	(77.4)	(77.4)
Total movements from financing cash flows	239.6	–	(77.4)	162.2
Fair value and other non-cash movements	(0.1)	18.8	(23.0)	(4.3)
Other movements	–	–	95.3	95.3
Total liability-related other movements	(0.1)	18.8	72.3	91.0
At 31 December 2018	1,327.7	1,093.7	39.4	2,460.8

(i) External interest payable of £23.8 million (2017 £23.7 million) and internal interest payable of £15.6 million (2017 £20.8 million) are included within Trade and other payables (refer to Note 47).

47 TRADE AND OTHER PAYABLES

	Note	2018 £m	2017 £m
Current trade and other payables:			
Payables due to Iberdrola group companies – trade		10.8	9.6
Payables due to Iberdrola group companies – interest		15.6	20.8
Trade payables		25.3	17.0
Other taxes and social security		2.4	8.6
Payables received on account		1.4	1.3
Capital payables		7.8	6.3
Other payables		30.0	29.5
		93.3	93.1
Non-current other payables:			
Payables due to Iberdrola group companies – trade	(a)	55.9	39.1
Payables received on account		28.0	29.2
Other payables		2.5	1.2
		86.4	69.5

(a) This balance represents other payables recognised as part of a contractual renegotiation.

48 COMPANY INCOME STATEMENT

As permitted by Section 408 of the Companies Act 2006, the company has not presented its own income statement. The company's income statement was approved by the Board on 29 April 2019. The profit for the financial year per the Accounts of the company was £547.6 million (2017 £346.2 million).

NOTES TO THE COMPANY ACCOUNTS *continued*

31 December 2018

49 EMPLOYEE INFORMATION

(a) Staff costs

	2018 £m	2017 £m
Wages and salaries	32.9	29.8
Social security costs	3.8	3.4
Pension and other costs	7.5	25.7
Total staff costs	44.2	58.9
Less: capitalised staff costs	(0.7)	(0.7)
Charged to the income statement	43.5	58.2

(b) Employee numbers

Details of the year end and average number of employees (full and part time) employed by the company, including UK based directors, can be found within the Corporate category of Note 22(b).

(c) Pensions

The company's contributions in the year were £7.6 million (2017 £6.9 million). The company contributes to the group's defined benefit and defined contribution schemes in the UK. Full details of these schemes can be found in Note 16.

50 AUDITOR REMUNERATION

The auditors' remuneration of the ScottishPower group is billed on a group basis and is not recharged to the company. Of the total group audit fee for the year ended 31 December 2018, £19,400 (2017 £20,000) related to the audit of the company Accounts. The total auditors' remuneration for the group is disclosed in Note 33 to the consolidated Accounts.

51 DIVIDENDS

	2018 pence per ordinary share	2017 pence per ordinary share	2018 £m	2017 £m
Interim dividend paid	12.8	6.8	563.2	300.0

52 FINANCIAL COMMITMENTS

	2018						Total £m
	2019 £m	2020 £m	2021 £m	2022 £m	2023 £m	2024 and thereafter £m	
Other contractual commitments	29.9	25.0	9.1	3.1	3.1	3.0	73.2

	2017						Total £m
	2018 £m	2019 £m	2020 £m	2021 £m	2022 £m	2023 and thereafter £m	
Other contractual commitments	35.3	28.9	24.0	9.1	3.0	3.0	103.3

NOTES TO THE COMPANY ACCOUNTS *continued*

31 December 2018

53 RELATED PARTY TRANSACTIONS

(a) Transactions and balances arising in the normal course of business

	2018				2017			
	Ultimate parent company (Iberdrola, S.A.) £m	Immediate parent (Scottish Power Limited) £m	Subsidiary companies £m	Other Iberdrola group companies £m	Ultimate parent company (Iberdrola, S.A.) £m	Immediate parent (Scottish Power Limited) £m	Subsidiary companies £m	Other Iberdrola group companies £m
Types of transaction								
Sales and rendering of services	0.2	1.3	152.9	0.8	0.5	1.5	175.3	4.5
Purchases and receipt of services	(41.8)	–	(2.3)	–	(37.5)	–	(3.7)	–
Finance income	–	–	70.2	–	–	–	67.8	–
Finance costs	–	(15.7)	(1.8)	–	–	(20.8)	–	–
Change in the value of cash flow hedge reserve	–	0.1	–	–	–	0.2	–	–
Dividends received	–	–	563.2	–	–	–	378.5	–
Dividends paid	–	(563.2)	–	–	–	(300.0)	–	–
Pensions contributions received	–	–	61.9	–	–	–	106.3	–
Capital contribution	–	–	412.2	–	–	–	–	–
ECLs recognised in respect of	–	–	–	–	–	–	–	–
Trade and other receivables	–	–	(0.1)	–	–	–	–	–
Loans and interest receivable	–	–	0.1	–	–	–	–	–
Balances outstanding								
Loans receivable	–	–	2,868.2	–	–	–	2,711.2	–
Trade receivables	–	–	6.2	0.8	–	–	10.2	0.5
Interest receivable	–	–	26.1	–	–	–	28.4	–
Derivative financial assets	–	0.1	–	–	–	–	–	–
Loans payable	–	(1,280.4)	–	–	–	(1,020.8)	(24.2)	–
Trade payables	–	–	(66.7)	–	–	–	(48.7)	–
Interest payable	–	(15.6)	–	–	–	(20.8)	–	–
ECLs on								
Trade and other receivables	–	–	(0.1)	–	–	–	–	–
Loans and interest receivable	–	–	(1.9)	–	–	–	–	–

(i) The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received.

(b) Remuneration of key management personnel

The remuneration of the key management personnel of the company is set out below. As all three (2017 three) of the key management personnel are remunerated for their work for the ScottishPower group, it has not been possible to apportion their remuneration specifically in respect of their services to this company. During the year all (2017 all) of the key management personnel were remunerated by the company.

	2018 £m	2017 £m
Short-term employee benefits	0.8	0.7
Post-employment benefits	0.2	0.2
Share-based payments	0.4	0.5
	1.4	1.4

(c) Directors' remuneration

Details of directors' remuneration are set out at Note 32(c).

(d) Ultimate parent company

The directors regard Iberdrola, S.A. as the ultimate parent company, which is also the parent company of the largest group in which the results of the company are consolidated. The parent company of the smallest group in which the results of the company are consolidated is Scottish Power Limited.

Copies of the consolidated Accounts of Iberdrola, S.A. may be obtained from Iberdrola, S.A., at its registered office, Torre Iberdrola, Plaza Euskadi 5, 48009, Bilbao, Spain. Copies of the consolidated Accounts of Scottish Power Limited may be obtained from its registered office, 320 St. Vincent Street, Glasgow, G2 5AD.

In addition to the parent undertakings disclosed above, the company's other related undertakings are disclosed in Note 5.

54 GOING CONCERN

The company's business activities, together with the factors likely to affect its future development and position, are set out in the Strategic Report on pages 1 to 13.

The company has recorded a profit after tax and positive net cash flows in both the current and previous financial years and the company's balance sheet shows that it has net current liabilities of £525.8 million and net assets of £3,866.7 million. Refer to Note 35 for details of the continuing profitability and going concern of the SPUK plc group.

The company is ultimately owned by Iberdrola, S.A. and it participates in the Iberdrola group's centralised treasury arrangements and shares banking facilities with its parent companies and fellow subsidiaries. As a consequence, the company depends, in part, on the ability of the Iberdrola group to continue as a going concern. The directors have considered the company's funding relationship with Iberdrola to date and have considered available relevant information relating to Iberdrola's ability to continue as a going concern. In addition, the directors have no reason to believe that the Iberdrola group does not have the ability to and will not continue to fund the company to enable it to continue in operational existence.

On the basis of these considerations, the directors have a reasonable expectation that the company will be able to continue in operational existence for the foreseeable future. Therefore, they adopt the going concern basis of accounting in preparing the Accounts.

Scottish Power UK plc

Registered office: 320 St. Vincent Street, Glasgow, Scotland, G2 5AD

Registered in Scotland: No. SC117120