

S2. SUMMARY OF MATERIAL ACCOUNTING POLICIES

(k) Hedge accounting

The Group continues to apply the hedge accounting requirements of IAS 39 and has not adopted IFRS 9 hedge accounting.

For the purposes of hedge accounting, hedges are classified as either fair value hedges or cash flow hedges. Note S5 details the Group's accounting policies in relation to derivatives qualifying for hedge accounting under IAS 39.

(l) Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. The Group accounts for financial guarantee contracts under IFRS 9.

(m) Impairment of financial assets

In accordance with IFRS 9, the Group has applied the expected credit loss model to financial assets measured at amortised cost and to investments in debt instruments measured at fair value through other comprehensive income.

For trade receivables and contract assets the simplified approach is taken and the lifetime expected credit loss provided for.

For all other in-scope financial assets at the balance sheet date either the lifetime expected credit loss or a 12-month expected credit loss is provided for, depending on the Group's assessment of whether the credit risk associated with the specific asset has increased significantly since initial recognition. As the Group's financial assets are predominantly short-term (less than 12 months), the impairment loss recognised is not materially different using either approach. Further details of the assumptions and inputs used to calculate expected credit losses are shown in note 17.

Nuclear activity

The Group's investment in Lake Acquisitions Limited ('Nuclear') is accounted for as an associate. The following accounting policies are specific to this nuclear activity.

(a) Fuel costs – nuclear front end

Front-end fuel costs consist of the costs of procurement of uranium, conversion and enrichment services, and fuel element fabrication. All costs are capitalised into inventory and charged to the Group Income Statement in proportion to the amount of fuel burnt.

(b) Fuel costs – nuclear back end

Advanced gas-cooled reactors (AGR)

Spent fuel extracted from the reactors is sent for reprocessing and/or long-term storage and eventual disposal of resulting waste products. Back-end fuel costs comprise of a loading-related cost per tonne of uranium and a rebate/surcharge to this cost which is dependent on the out-turn market electricity price and the amount of electricity generated from AGR stations in the year. These costs are capitalised into inventory and charged to the Group Income Statement in proportion to the amount of fuel burnt.

Pressurised water reactor (PWR)

Back-end fuel costs are based on wet storage in station ponds followed by dry storage and subsequent direct disposal of fuel. Back-end fuel costs are capitalised into inventory on loading and are charged to the Group Income Statement in proportion to the amount of fuel burnt.

(c) Nuclear PP&E – depreciation

The majority of the cost of the nuclear fleet is depreciated from the date of the Group acquiring its share of the fleet on a straight-line basis, with remaining depreciable periods currently of up to 32 years.

Other expenditure including amounts spent on major inspections and overhauls of production plant is depreciated over the period until the next outage which for AGR power stations is 2 to 3 years and for the PWR power station is 18 months.

(d) Nuclear Liabilities Fund (NLF) funding arrangements

Under the arrangements in place with the Secretary of State, the NLF will fund, subject to certain exceptions, qualifying uncontracted nuclear liabilities and qualifying decommissioning costs.

In part consideration for the assumption of these liabilities by the Secretary of State and the NLF, the former British Energy Group agreed to pay fixed decommissioning contributions each year and £150,000 (indexed to RPI) for every tonne of uranium in PWR fuel loaded into the Sizewell B reactor after the date of these arrangements.

(e) NLF and nuclear liabilities receivables

The UK Government indemnity is provided to indemnify any future shortfall on NLF funding of qualifying uncontracted nuclear liabilities (including PWR back-end fuel services) and qualifying nuclear decommissioning costs such that the receivable equals the present value of the associated qualifying nuclear liabilities (apart from a small timing difference due to timing of receipts from NLF).

(f) Nuclear liabilities

Nuclear liabilities represent provision for liabilities in respect of the costs of waste management of spent fuel and nuclear decommissioning.

(g) Unburnt fuels at shutdown

Due to the nature of the nuclear fuel process there will be quantities of unburnt fuel in the reactors at station closure. The costs relating to this unburnt fuel (final core) are fully provided for at the balance sheet date. The provision is based on a projected value per tonne of fuel remaining at closure, discounted back to the balance sheet date and recorded as a long-term liability.