

Notes to the consolidated financial statements

- analysis of items in the primary statements continued

Unaudited commentary on the results of our principal operations by segment continued

Commentary on UK regulated financial performance

The regulated financial performance calculation provides a measure of the performance of the regulated operations before the impacts of interest and taxation. It adjusts reported operating profit under IFRS to reflect the impact of the businesses' regulatory arrangements when presenting financial performance.

Adjustments in calculating regulatory financial performance

The principal adjustments from reported operating profit to UK regulated financial performance are:

Movement in UK regulatory 'IOUs': Revenue related to performance in one year may be recovered in later years. Revenue may be recovered in one year but be required to be returned to customers in future years. IFRS recognises these revenues when they flow through invoices to customers and not in the period to which they relate.

Performance RAV: UK performance efficiencies are in part remunerated by the creation of additional RAV which is expected to result in future earnings under regulatory arrangements.

Pension adjustment: Cash payments against pension deficits in the UK are recoverable under regulatory contracts.

3% RAV indexation: Future UK revenues expected to be set using an asset base adjusted for inflation. This will be billed in future periods and recognised under IFRS at that time.

UK deferred taxation adjustment: Future UK revenues are expected to recover cash taxation cost including the unwinding of deferred taxation balances created in the current year.

Regulatory depreciation: US and UK regulated revenues include allowance for a return of regulatory capital in accordance with regulatory assumed asset lives. This return does not form part of regulatory profit.

Fast/slow money adjustment: The regulatory remuneration of costs incurred is split between in year revenue allowances and the creation of additional RAV. This does not align with the classification of costs as operating costs and fixed asset additions under IFRS accounting principles.

UK Electricity Transmission

Regulated financial performance for UK Electricity Transmission increased to £1,232m from £1,066m, up 16%. The year on year movement reflected the higher opening regulated asset value and the higher achieved operational return on equity. There was also a one-off benefit of £56m from legal settlements. These were partially offset by a reduced price control 'tracker' cost of debt allowance.

Reconciliation of regulated financial performance to operating profit	2015 £m	2014 £m	% change
Reported operating profit	1,237	1,087	14
Movement in regulatory 'IOUs'	(130)	(19)	
Deferred taxation adjustment	88	53	
RAV indexation (average 3% long-run inflation)	326	301	
Regulatory vs IFRS depreciation difference	(352)	(337)	
Fast/slow money adjustment	34	(2)	
Pensions	(48)	(47)	
Performance RAV created	77	30	
Regulated financial performance	1,232	1,066	16

UK Gas Transmission

Regulated financial performance for UK Gas Transmission increased to £648m from £552m, up 17%. This reflected improved operational return on equity, mainly as a result of incentive performance, and the increase in underlying revenues associated with increased regulated asset value. This was partly offset by lower allowed cost of debt (2.72% real compared with 2.92% real in 2013/14).

Reconciliation of regulated financial performance to operating profit	2015 £m	2014 £m	% change
Reported operating profit	437	417	5
Movement in regulatory 'IOUs'	(16)	(28)	
Deferred taxation adjustment	85	12	
RAV indexation (average 3% long-run inflation)	166	162	
Regulatory vs IFRS depreciation difference	(22)	(2)	
Fast/slow money adjustment	54	44	
Pensions	(49)	(46)	
Performance RAV created	(7)	(7)	
Regulated financial performance	648	552	17

UK Gas Distribution

Regulated financial performance for UK Gas Distribution decreased to £819m from £855m. The year on year movement in regulated financial performance reflected an increase in underlying revenues associated with increased regulated asset value, more than offset by lower allowed cost of debt and a slightly reduced achieved return on equity.

Reconciliation of regulated financial performance to operating profit	2015 £m	2014 £m	% change
Reported operating profit	826	904	(9)
Movement in regulatory 'IOUs'	(28)	(59)	
Deferred taxation adjustment	60	85	
RAV indexation (average 3% long-run inflation)	255	252	
Regulatory vs IFRS depreciation difference	(148)	(149)	
Fast/slow money adjustment	(182)	(197)	
Pensions	(5)	(9)	
Performance RAV created	41	28	
Regulated financial performance	819	855	(4)

3. Operating costs

Below we have presented separately certain items included in our operating costs. These include a breakdown of payroll costs (including disclosure of amounts paid to key management personnel) and fees paid to our auditors.

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

	Before exceptional items, remeasurements and stranded cost recoveries			Exceptional items, remeasurements and stranded cost recoveries			Total		
	2015 £m	2014 £m	2013 £m	2015 £m	2014 ¹ £m	2013 ¹ £m	2015 £m	2014 ¹ £m	2013 ¹ £m
Depreciation and amortisation	1,482	1,416	1,361	-	-	-	1,482	1,416	1,361
Payroll costs	1,459	1,373	1,434	-	(155)	26	1,459	1,218	1,460
Purchases of electricity	1,615	1,513	1,251	70	(49)	(111)	1,685	1,464	1,140
Purchases of gas	1,403	1,722	1,384	13	33	(69)	1,416	1,755	1,315
Rates and property taxes	1,004	963	969	-	-	-	1,004	963	969
Balancing Services Incentive Scheme	874	872	805	-	-	-	874	872	805
Payments to other UK network owners	801	630	487	-	-	-	801	630	487
Other	2,700	2,656	3,029	-	100	44	2,700	2,756	3,073
	11,338	11,145	10,720	83	(71)	(110)	11,421	11,074	10,610
Operating costs include:									
Inventory consumed							365	422	389
Operating leases							98	115	109
Research and development expenditure							23	12	15

1. Comparatives have been represented on a basis consistent with the current year presentation.

(a) Payroll costs

	2015 £m	2014 ¹ £m	2013 ¹ £m
Wages and salaries ²	1,598	1,377	1,597
Social security costs	129	126	120
Other pension costs (note 22)	224	229	234
Share-based payment	20	20	20
Severance costs (excluding pension costs)	4	30	16
	1,975	1,782	1,987
Less: payroll costs capitalised	(516)	(564)	(527)
	1,459	1,218	1,460

1. Comparatives have been represented on a basis consistent with the current year presentation.

2. Included within wages and salaries are US other post-retirement benefit costs of £39m (2014: £44m; 2013: £43m); a curtailment gain on LIPA MSA transaction of £nil (2014: £198m; 2013: £nil) and a curtailment loss following disposal of businesses of £nil (2014: £nil; 2013: £1m). For further information refer to note 22.

(b) Number of employees

	31 March 2015	Monthly average 2015	31 March 2014	Monthly average 2014	31 March 2013	Monthly average 2013
UK	9,701	9,670	9,693	9,641	9,990	9,816
US	14,573	14,434	14,216	15,094	15,438	15,555
	24,274	24,104	23,909	24,735	25,428	25,371

The vast majority of employees in the US are either directly or indirectly employed in the transmission, distribution and generation of electricity or the distribution of gas, while those in the UK are either directly or indirectly employed in the transmission and distribution of gas or the transmission of electricity. At 31 March 2015, there were 2,131 (2014: 2,044; 2013: 2,151) employees in other operations, excluding shared services.

Notes to the consolidated financial statements

- analysis of items in the primary statements continued

3. Operating costs continued

(c) Key management compensation

	2015 £m	2014 £m	2013 £m
Short-term employee benefits	10	9	8
Post-employment benefits	9	1	3
Share-based payment	4	5	5
	23	15	16

Key management compensation relates to the Board of Directors, including the Executive Directors and Non-executive Directors for the years presented.

(d) Directors' emoluments

Details of Directors' emoluments are contained in the audited part of the Remuneration Report on page 69, which forms part of these financial statements.

(e) Auditors' remuneration

Auditors' remuneration is presented below in accordance with the requirements of the UK Companies Act 2006 and the principal accountant fees and services disclosure requirements of Item 16C of Form 20-F:

	2015 £m	2014 ¹ £m	2013 £m
Audit fees² payable to the parent Company's auditors and their associates in respect of:			
Audit of the parent Company's individual and consolidated financial statements	1.3	0.9	1.1
The auditing of accounts of any associate of the Company	8.1	9.2	6.0
Other services supplied ³	3.3	3.2	2.7
	12.7	13.3	9.8
Total other services⁴			
Tax fees ⁵ :			
Tax compliance services	0.4	0.5	0.5
Tax advisory services	0.1	0.3	0.3
All other fees ⁶ :			
Other assurance services	0.1	0.1	0.1
Services relating to corporate finance transactions not covered above	-	-	0.3
Other non-audit services not covered above	0.3	0.8	1.1
	0.9	1.7	2.3
Total auditors' remuneration	13.6	15.0	12.1

- The audit fees for the year ended 31 March 2014 have been restated to reflect the final audit fee following completion of the statutory audit process.
- Audit fees in each year represent fees for the audit of the Company's financial statements and regulatory reporting for the years ended 31 March 2015, 2014 and 2013, and the review of interim financial statements for the six month periods ended 30 September 2014, 2013 and 2012 respectively.
- Other services supplied represent fees payable for services in relation to other statutory filings or engagements that are required to be carried out by the auditors. In particular, this includes fees for reports under section 404 of the US Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley) and audit reports on regulatory returns.
- There were no audit related fees as described in Item 16C(b) of Form 20-F.
- Tax fees include amounts charged for tax compliance, tax advice and tax planning.
- All other fees include amounts relating to market research on the metering industry and sundry services, all of which have been subject to approval by the Audit Committee. Total other fees for the year ended 31 March 2015 were £0.4m (2014: £0.9m; 2013: £1.5m).

In addition, fees of £0.2m were incurred in 2015 in relation to the audits of the pension schemes of the Company (2014: £0.1m; 2013: £0.1m).

Subject to the Company's Articles of Association and the Companies Act 2006, the Audit Committee is solely and directly responsible for the approval of the appointment, reappointment, compensation and oversight of the Company's independent auditors. It is our policy that the Audit Committee must approve in advance all non-audit work in excess of £50,000 to be performed by the independent auditors to ensure that the service will not compromise auditor independence. The Committee has delegated the approval in advance for all non-audit work below this level to the Finance Director. Certain services are prohibited from being performed by the external auditors under the Sarbanes-Oxley Act 2002.