

Annual Report and Accounts for Electricity Settlements Company Limited 2017/18

Our vision...

is to be at the heart of the delivery of the UK's goals for secure, affordable and sustainable energy

ESC's Guiding Principle is **to maintain market participants' confidence** in the Capacity Market settlement process and **minimise costs to consumers.**¹

Electricity Settlements Company (ESC) is an independent, not-for-profit private company, wholly owned by the Secretary of State for Business, Energy and Industrial Strategy (BEIS). The company carries out a key role in the delivery of the government's objective of "ensuring that the country has **secure energy supplies that are reliable, affordable and clean**"²:

ESC is the **Capacity Market Settlement Body**, responsible for managing all financial transactions and associated assurances under the Capacity Market scheme, such as: credit cover; meter assurance; penalties; and payments to capacity providers.

"The Capacity Market is designed to use competition to achieve a defined level of electricity security in Great Britain at the lowest cost to consumers."³

¹ ESC Framework Document available at <https://lowcarboncontracts.uk/corporate-governance>

² BEIS Single Departmental Plan, published December 2017: <https://www.gov.uk/government/publications/department-for-business-energy-and-industrial-strategy-single-departmental-plan/department-for-business-energy-and-industrial-strategy-single-departmental-plan>

³ BEIS Publication: "Capacity Market Consultation – Improving the Framework", published December 2017: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/664272/capacity-market-consultation-improving-framework-response.pdf

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Highlights for 2017/18

Capacity Market scheme delivery

Delivering Excellence

438 agreements under settlement

for capacity providers successful in the 2016/17 Capacity Market

£234.3m

total credit cover managed

Developing as a Centre of Expertise

Delivered 24 changes to our settlement system and operations

required by revisions to the Capacity Market rules, including enabling Secondary Trading by Volume Reallocation

“[This year] alongside scheme changes, we have also seen changes in the level of participation, as we scaled up to a market-wide roll out and saw growth in the number of bespoke metering arrangements requiring validation.”

Neil McDermott
Chief Executive

Acting as a Trusted Advisor

Proposed 12 rule changes to improve settlement

in our response to Ofgem's Capacity Market rule consultation

Assured Delivery in a Changing Environment



I am pleased to report another successful year for the Electricity Settlements Company and a further step forward in its operational strength and capability.

The Capacity Market is now operating at full scale. Winter 2017/18 was the start of the first full Capacity Market Delivery Year, in which we carried out the settlements for 54.7GW of capacity agreements issued in 2016/17 and verified meter arrangements for new entrants. ESC also managed credit cover for this year's Capacity Auctions, which saw an unprecedented number of participants and the lowest clearing prices to date – £8.40/kW in the four-year ahead auction and £6/kW in the one-year ahead auction.

Delivery excellence

Over the year, we have successfully implemented a considerable volume of Ofgem changes to the Capacity Market rules on settlement. The scheme is now having a real impact on electricity generation in the UK, with the Capacity Market ensuring a capacity margin of 6.2% during 2017/18⁴.

A strong team

ESC's activities are carried out in full by the Low Carbon Contracts Company (LCCC) through a cost-sharing arrangement that delivers efficiencies of scale. We continue to benefit from an experienced board, a capable management team, and deep relationships across the sector. The strong performance and momentum that has been achieved by the company this year would not have been possible without the hard work of our people and I would like to thank them for their commitment and efforts.

At the heart of a changing market

Britain's carbon emissions from the electricity sector have halved since 2012⁵. Renewables look set to compete with traditional power sources. New storage technology has the potential to add significantly to the use of renewable power. We have therefore looked

beyond the delivery of our regulatory duties to review the anticipated challenges to the application of the Capacity Market to new technologies and business models.

We are working closely with government, Ofgem and other delivery agents to play our role in evolving the current Capacity Market arrangements. One example is the implementation of 'Volume Reallocation', which enables capacity providers to transfer their obligations to another party for specified periods, for example during planned maintenance outages. This year, ESC has also proposed 12 changes to the Capacity Market rules aimed at improving the operation of the scheme. We stand ready to provide our expertise to assist government in exploring options for future market reforms.

Looking ahead

With so much innovation in this sector, all organisations, both public and private, need to continually adapt. We recognise that our market is a rapidly evolving one with many opportunities, uncertainties and complexities. For us, continually changing systems and processes is "business as usual". I am confident that the company has developed the skills and competence to succeed in this fast-changing environment.



Dr Martin Read CBE
Chair

⁴Out of a total capacity margin of 10.3% of underlying demand, as stated on page 16 of National Grid's Winter Outlook: <https://www.nationalgrid.com/sites/default/files/documents/Winter%20Outlook%202017.pdf>

⁵Source: National Grid data; <http://media.nationalgrid.com/press-releases/uk-press-releases/corporate-news/national-grid-confirms-summer-2017-as-greenest-ever-and-launches-world-s-first-green-energy-forecast/>



©2018 Low Carbon: <http://www.lowcarbon.com>

Glassenbury battery storage park, a 40MW storage project in Kent, was awarded a three-year capacity agreement in 2016 and became operational in 2018.

Building on our Strengths



The past year, 2017, was an important time for ESC and its role in the Capacity Market scheme.

In October we entered the first market-wide Delivery Year, requiring ESC to settle over 400 capacity agreements issued in 2016/17 to 54.7GW of capacity. ESC performed the necessary meter assurance activities and set up new regular payments, which were all carried out within the required timescales. It has been interesting to observe both the recent year-ahead (T-1) and four year-ahead (T-4) Capacity Auctions settling at the lower end of price expectations.

Keeping pace with a changing market

Business change and continuous improvement resulting from externally driven change to rules or regulations are part of our business as usual these days. This year, we implemented several changes to our settlements systems as a direct result of new developments in the Capacity Market scheme - such as Secondary Trading functionality, which is now fully operational, and the introduction of interconnectors to the market. Alongside scheme changes, we have also seen changes in the level of participation, as we scaled up to a market-wide roll out and saw growth in the number of bespoke metering arrangements requiring validation.

All these achievements have been made while keeping our costs within budget. Our net operating expenditure of **£5.5m** compares to a budget of **£6.2m** and enables us to return **£0.7m** of unspent operational costs to suppliers.

Increasing the value of our activities

This year also saw ESC achieve its three-year anniversary – an opportune time for us to revisit our company strategy. We have now set a refreshed mission for the type of company and delivery body we want to be. This allows us to focus on further improving the quality of our services to our key stakeholders such as the government, scheme participants and electricity suppliers. We have also for the first time committed to a three-year budget which gives more certainty over our future operational costs.

I'm excited by the opportunity our strategy provides for us to look at how we can add more value to our shareholder, delivery partners and wider stakeholders. This is a natural "coming of age" for a company that is seeking to grow its offering in terms of providing enhanced information and insights on the operation and development of the Capacity Market.

An example of this is the Capacity Market rule change proposals we put forward to Ofgem in October 2017. These change proposals demonstrate how we are deploying our expertise with the aim of improving the schemes for the future.

Looking ahead

We are beginning to see technological innovation within the industry coming through in the form of the changing nature of scheme participants, including an increasing volume of Demand Side Response and bespoke behind-the-meter configurations, such as combined generating, storage and Demand Side Response facilities.

Looking ahead, it will be interesting to see how the market adapts to an increase in these behind-the-meter services and whether we will see new solar and onshore wind generation able to play a role going forward.

So, it seems inevitable that the future will look very different against the backdrop of technological innovation in the energy and transport sectors, as well as smarter, tech-enabled consumption.

Fundamentally, what will remain important is the need to maintain investor confidence in the electricity sector so that we can continue to build on the progress of the last three years towards a secure, decarbonised supply that is affordable for all consumers.

A handwritten signature in black ink, appearing to read "Neil McDermott". The signature is fluid and cursive, written on a white background.

Neil McDermott
Chief Executive



©Limejump Ltd

The 9.8MW Leverton battery facility, owned and operated by Eelpower, secured a T-1 contract in January 2018, having secured a 15-year T-4 capacity agreement in 2016.

Corporate report

Our role in delivering affordable, reliable and clean electricity

ESC plays a key role in supporting the government's objective to ensure the UK has a secure and resilient energy system, by managing the financial transactions and associated assurances required pre- and post-auction under the Capacity Market scheme.

The Capacity Market is designed to provide payment for reliable sources of capacity, both to ensure that electricity is available when needed and to provide sufficient backup for more intermittent and inflexible low carbon generation sources. The Capacity Market has also been designed to support the development of more active demand management in the electricity market.

We are responsible for Capacity Market payments and related activities. This includes

holding credit cover for auction participants and conducting the meter tests for successful applicants which are required before they can start receiving payments.

Our sister company, LCCC, delivers all Capacity Market activities on behalf of ESC under a cost sharing arrangement. This enables efficient governance of settlement across the Capacity Market and CFD schemes, including through the management of a shared settlement service.

Table: 2017/18 Capacity Market outcomes

Scheme	Outcome	Total payments made by ESC to capacity providers during 2017/18	Total estimated ⁶ cost per household for 2017/18 (including ESC operational cost levy)
Capacity Market	54.7GW of capacity ⁷	£220.7m	£2.95

Capacity margins in 2017/18

The Capacity Market is designed to ensure security of electricity supply by providing payments to reliable sources of capacity, alongside electricity revenues, to ensure the delivery of electricity when needed. According to the System Operator (National Grid), the Capacity Market has increased the amount of available supply in the market, with capacity margin in winter 2017/18 (1 October 2017 to 31 March 2018) resulting from capacity secured through the Capacity Market estimated to be 6.2% of underlying demand, out of a total margin of 10.3% of underlying demand⁸.

⁶ Estimated by adding total scheme payments to ESC operational costs (£5.5m), and dividing by total eligible demand, assumed to be 301.5TWh, multiplied by an estimated average domestic consumption per household of 3,931kWh, as per BEIS published estimate, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/675915/Sub-national_electricity_consumption_statistics_2005-16.xlsx. Note this does not include operational costs of other delivery partners such as BEIS or National Grid.

⁷ This is based on the Capacity Market Registers as published by National Grid on 4 May 2018: <https://www.emrdeliverybody.com/CM/cm-register.aspx>. Also see notes to Figure 1.

⁸ <https://www.nationalgrid.com/sites/default/files/documents/Winter%20Outlook%202017.pdf>

Capacity Market Developments

Capacity provider management

In accordance with the Capacity Market rules, we delivered, on behalf of ESC, 172 meter tests during 2017/18 and made payments of £220.7m in exchange for 54.7GW of reliable capacity to be made available to National Grid as System Operator. In addition, we managed credit cover for Capacity Market auctions, with the total credit cover managed this year being £234.3m.

Growth in Optimisation technologies

This year the amount of T-4 capacity agreements awarded to Demand Side Response capacity providers increased to 1,206MW as a result of the September 2017 auction (making up 24.7% of the total number of T-4 agreements awarded to the end of March 2018). Similarly, the amount of DSR capacity with T-1 capacity agreements increased to 443MW as a result of the January 2018 auction (making up 18.7% of the total T-1 agreements awarded to the end of March 2018).

Secondary Trading and Volume Reallocation

In July 2017 ESC and National Grid worked together to enable Secondary Trading functionality for capacity providers to partially or completely transfer their capacity agreements to another party for specified periods, for example during maintenance outages; and a Volume Reallocation mechanism enabling capacity providers who have over delivered during a system stress event to transfer excess capacity to other Capacity Market participants to assist these participants in delivering on their capacity obligations.

Capacity Market settlement

We have also implemented a regulatory change in the way we calculate the Capacity Market supplier charge so that a supplier's share is calculated on a gross basis. This aligns with the approach to the calculation of the CFD Supplier Obligation Levy.

Other major developments in our settlement operations delivered this year included:

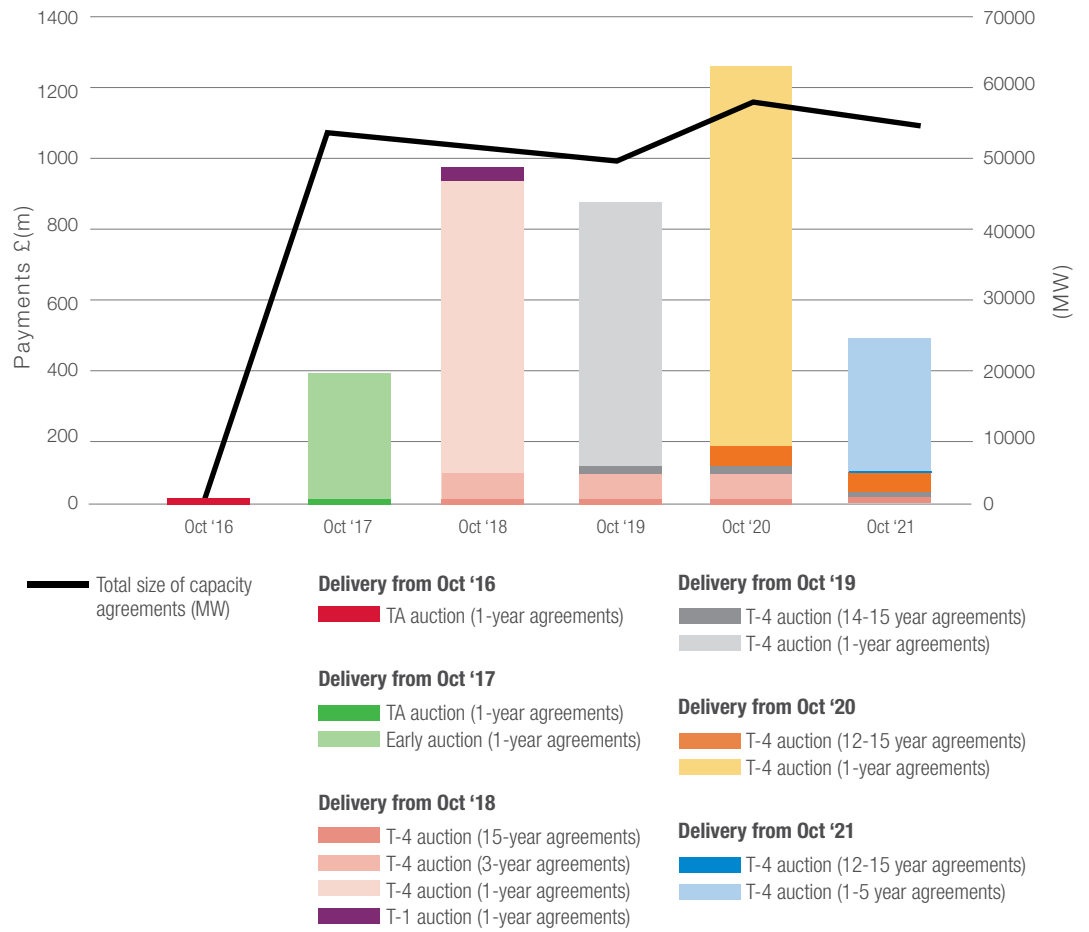
- delivering 100% of the 2017 Capacity Market Rules changes to settlement for all technology types;
- completing the Capacity Market Stress Event Test 2017 and planning a Stress Event Test for 2018, to include Volume Reallocation.
- providing Secondary Trading and vintage support for all current and historic Capacity Auctions.

We have also proposed 12 changes to the Capacity Market rules relating to settlement, aimed at improving the way that scheme data is collected and used between the application stage and the Delivery Year, which in some cases is four years after the auction that awarded the agreement.

Profile of Future Capacity Market Commitments

The committed capacity payments for future years, based on capacity agreements in place, is shown in figure 1. There is also the possibility of additional capacity being procured through future year ahead (T-1) auctions, which would result in further payments for "top-up" capacity.

Figure 1: Total cost of capacity agreements by auction and year



Notes:

Based on ESC information in the Capacity Market Registers published by National Grid on 4 May 2018. Archived Capacity Market Registers available at: <https://www.emrdeliverybody.com/CM/Registers.aspx>

In Focus: Flexitricity

Flexitricity was the only Demand Side Response provider in the first Capacity Market auction and is the only Demand Side Response company to hold Capacity Market contracts for all Delivery Years contracted so far.

ESC has been engaging with Flexitricity since 2014, offering it advice and guidance to help it meet key targets in delivering secure electricity supplies under the Capacity Market. Assistance from ESC to the company included guidance on Metering Statement requirements, Metering Test processes, aggregation rule templates and data submission.

On engaging with ESC, Flexitricity's founder and Chief Strategy Officer, Dr Alastair Martin, said: "The Capacity Market is highly complex, and our success within it has been crucially dependent on the professionalism and diligence of ESC.

"The processes and rules around metering, certification and proof of performance were all brand new when we started to make use of them; in fact, Flexitricity held the first DSR Test Certificates in issue. ESC put in the hours and applied the expertise necessary to make the Capacity Market work first time, and has since scaled its processes successfully to deal with the exponential rise in demand response participation since those early years. Without this, Flexitricity would not have been able to demonstrate the volume and variety of Demand Side Response participation that it has."



©Flexitricity

Ron Ramage CEO (left) and Dr Alastair Martin
CSO from Flexitricity



©Gateshead Council and Flexitricity
Gateshead Energy Centre



©Gateshead Council and Flexitricity

One of the Gateshead Energy Centre CHP engines, fulfilling a capacity agreement via Flexitricity

Environment report

The company does not have any employees.

Its role is performed on its behalf by LCCC. The company accordingly does not itself have any Scope 1, Scope 2, or Scope 3 emissions. The company is, however, committed to ensuring its sustainability objectives and works closely with LCCC in relation to environmental matters.

Strategic report

ESC plays an integral role in the implementation of the Capacity Market scheme by delivering the credit cover, meter assurance, levy collection and settlement functions required for the operation of the Capacity Market. The Capacity Market was introduced by the government in August 2014 with the aim of ensuring security of supply in future years while minimising the cost to consumers. ESC's strategy is delivered through LCCC.

“Building on our Strengths” – our new strategic plan

During 2017/18 we reviewed our company strategy. The review confirmed that our vision “to be at the heart of the delivery of the UK’s goals for secure, affordable and sustainable energy” remains appropriate. The review also provided us with the opportunity to refresh our mission to increase our outward focus, including by

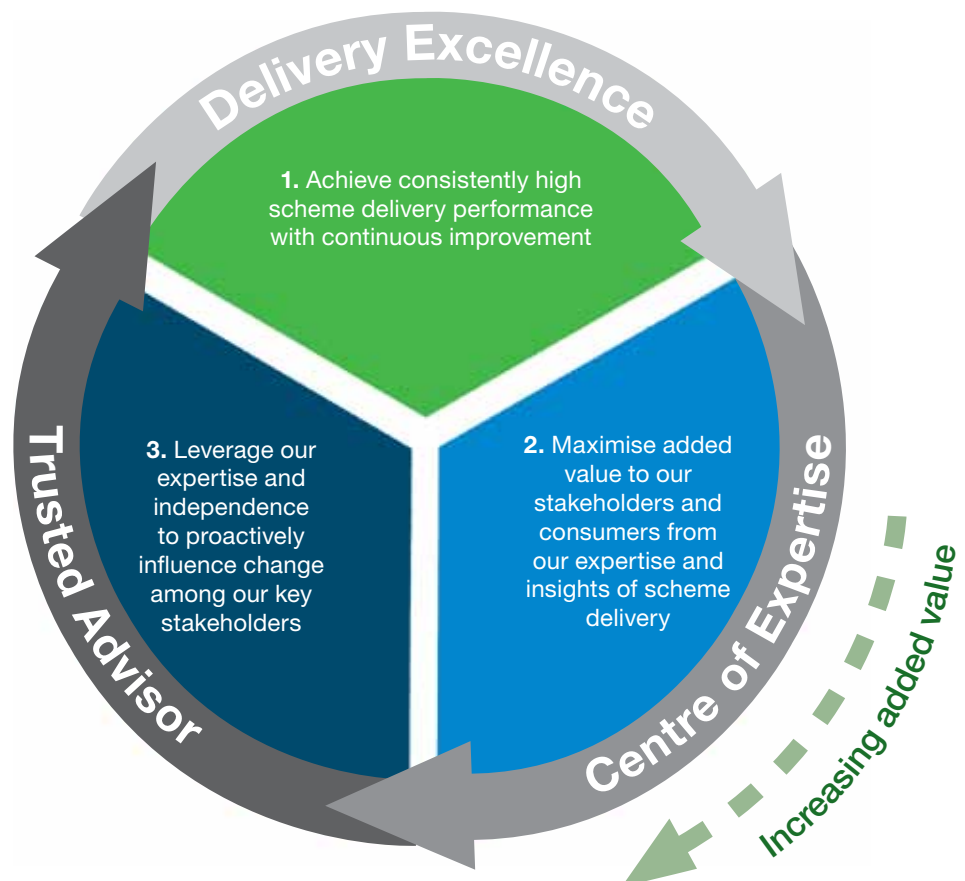
finding ways to provide added value to our key stakeholders. Our company strategy sets out how we intend to use the strong foundation of our ‘Delivery Excellence’ to develop as a ‘Centre of Expertise’ and ‘Trusted Advisor’ on policy and scheme implementation. This will enable ESC to position itself to assist government and industry in navigating the inevitable changes ahead for the electricity market as the market adapts to become more flexible, localised and digitalised.

Strategy, mission and vision

Our vision is to be at the heart of the delivery of the UK’s goals for secure, affordable and sustainable electricity.

Our mission is to implement and develop electricity market schemes, providing operational independence, expertise, insight and leadership.

Our Objectives



Principal activities

The principal activities of the company are further described on pages 2 to 11.

The company's functions are performed through LCCC, which gives cost savings and efficiencies due to the synergies between the operations of the two companies. The company has no plans to change this business model.

The company's performance

The company monitors its progress against its strategic objectives through key performance indicators ("KPIs"). The KPIs set out below have been defined by reference to the key milestones or targets for 2017/18 and therefore are not presented against the new Strategic Objectives referred to in the previous section, for which a different set of KPIs will be used to report in 2018/19.

Key performance indicator

Summary Description of Primary Performance Requirements

Financial and risk management performance

Delivering within operational and capital budgets - the financial and budget performance of the company was well managed with the company successfully delivering within ESC's operational and capital budgets. As a result, the company will be returning £0.7m to suppliers.

Effective controls - effective controls are in place to manage the financial performance of the company, including policies and procedures, monthly monitoring against budget and clear delegated authorities. Controls are also in place to identify, monitor and manage strategic risks, with mitigating actions being completed in a timely manner.

Capacity Market settlement activity

Delivering and managing the Capacity Market settlement operations and metering activity - the company has successfully performed its role in relation to the collection and administration of credit cover and the delivery of its metering assurance work. The company has ensured that the Capacity Market settlement system delivered capacity payments in accordance with its regulatory obligations and that 'releases' of planned further functionality developments to the system were delivered on time and budget.

Corporate governance and strategy – including leadership of company, organisational vision and structure

Effective external stakeholder management:

- the company has established effective external communications with stakeholders (in particular, BEIS, National Grid, Ofgem and Capacity Market stakeholders). Overall good results were received in feedback from stakeholder events, webinars and the company's annual stakeholder survey.

Strategy and business planning:

- the company's strategy, business plan and budget (factoring in workforce planning) have been prepared and agreed for the three years commencing in 2018/19.
 - further opportunities have been developed to extend the company's reputation as a trusted advisor to BEIS and wider government and as a centre of expertise in core business areas.
-

Overview of company's role

ESC is a BEIS departmental arm's length body set up to administer critical elements of the Capacity Market.

The Capacity Market was introduced to ensure that there is sufficient investment in the overall level of reliable capacity to provide secure electricity supplies to meet peak demand – e.g. during cold, windless periods. The Capacity Market was designed by BEIS to provide capacity providers awarded capacity agreements with a steady, predictable revenue stream upon which they are able to base their future investments. This revenue is paid as “capacity payments”.

Capacity agreements are rule based arrangements between National Grid (as system operator) and capacity providers. In return for the predictable revenue stream generated by the capacity agreements, capacity providers must deliver energy at times of system stress or face penalties.

Capacity providers can be new or existing generators, electricity storage providers and/or significant users of electricity who provide voluntary ‘demand side’ reduction. Potential capacity providers compete in Capacity Auctions to secure capacity agreements. The auction sets the level of the capacity payment.

The company's primary role is to “settle” the Capacity Market by making payments to capacity providers holding capacity agreements. It may also receive payments from capacity providers in the form of penalties, should they not make their agreed capacity available.

The company's main function is therefore to perform the levy collection and settlement role set out in the Electricity Capacity Regulations 2014 (as amended) and the Electricity Capacity (Supplier Payment etc.) Regulations 2014 (as amended) (the “Regulations”).

The company also collects credit cover provided by applicants to Capacity Auctions, paying the credit cover back to unsuccessful applicants and processing the credit cover of successful applicants in accordance with the requirements of the Regulations. This credit cover provides some security for the performance by capacity providers of their obligations under the Regulations.

The company also undertakes meter assurance activities to check that capacity providers are providing the capacity they are required to provide under their capacity agreements. These activities are mainly undertaken via outsourced subcontracting arrangements overseen by LCCC.

Financial overview

Capacity payments

The total amount of capacity payments made in the financial year was £220.7m. (2016/17: £9.2m).

The Delivery Year for the Capacity Market runs from 1 October to 30 September of each year. The capacity payments for each Delivery Year are summarised in the table below:

Capacity Market Delivery	2017/18 financial year	2016/17 financial year
Transitional Arrangements 2016/2017 (October 2016 to September 2017)	£7.4m	£9.2m
Transitional Arrangements 2017/2018 (October 2017 to September 2018)	£7.2m	–
Early Capacity Auction 2017/2018 (October 2017 to September 2018)	£206.1m	–

The company obtains the funds to make payments to capacity providers by charging electricity suppliers as set out in the Regulations. Suppliers are obliged to pay their charges within three working days of receipt of an invoice from the company, but the company does not have to make capacity payments until 29 working days after the end of the relevant month. This insulates the company against cashflow timing issues.

In the event that the amount needed by the company to pay to capacity providers in a particular month is less than the amount of charges collected from suppliers for that month, the company returns the 'difference' to suppliers. As at 31 March 2018, £2.3m in Capacity Market supplier charges was due to be returned to suppliers (2016/17: £2.8m).

Suppliers must also lodge credit cover as security against their failure to pay amounts for which they are liable. If, in due course, this credit cover is called upon and proves insufficient to cover the amount due from a particular supplier, the shortfall is "mutualised" between the remaining suppliers (i.e. the remaining suppliers have to make up the shortfall between them). As at 31 March 2018, the company held £6.5m in supplier credit cover (2016/17: £1.05m). During the year £0.02m of supplier payments were mutualised to other suppliers (2016/17: £0.02m).

Where the company receives penalty monies from capacity providers, it pays these monies to suppliers. If a capacity provider fails to pay an amount due from it and, as a result, the company does not make an expected payment to suppliers, the shortfall is borne by suppliers (i.e. it is shared between them). The company has no obligation to make up any shortfall.

Operational costs

The day to day operational costs of the company are funded by suppliers under the annual fixed 'settlement' or operational costs charges set by the Electricity Capacity (Supplier Payment etc.) Regulations 2014 as amended (the "Supplier Payment Regulations"). The amount set out in the Supplier Payment Regulations is amended by Parliament, after public consultation, to reflect the required operational costs amount applicable for the relevant financial year. The amount is then divided between suppliers and charged to them in accordance with their market share.

The total settlement costs charges for 2017/18 was fixed at £6.2m and for 2018/19 is fixed at £7.629m. The Supplier Payment Regulations have also, for the first time, set the total charges for two further years:

Year	Budget
2018/19	£7.629m
2019/20	£7.554m
2020/21	£7.502m

The company has delivered its operational role within the budget set by the operational costs levy for 2017/18. The company applies strong financial management in order to ensure that its commitments are managed within the timing of its collection of the settlement costs levy.

The company shares resources with LCCC, which are paid for by LCCC with the proportion of the costs related to the Capacity Market being recharged to ESC, as further set out in note 2.6 to the financial statements.

The total net operating costs of the company for the year were £5.5m (2016/17: £2.9m). As a result of its strong financial performance over the financial year, the company will return £0.7m to suppliers for 2017/18 (2016/17: £1.4m).

There have been a number of contributory factors to the company's performance, including the level of resources deployed by the outsourced settlement system provider being lower than expected and a reduction in directly attributable costs for electricity settlement which has resulted in total savings of £0.7m (2016/17: £0.6m).

Post balance sheet events

There are no post balance sheet events to be recognised or disclosed.

Viability statement

The directors have assessed the company's prospects, taking into account the company's current position and the principal risks faced by it over the projected business plan period of three years. The period of three years has been chosen as this is the (i) time period over which the company has reasonable visibility of its strategy implementation and business planning, (ii) period for which the operational costs levy has been set by Parliament in the relevant regulations, and (iii) period in respect of which the company has established its related three-year business plan and budget.

The financial arrangements relating to the company minimise the risk of the company being unable to meet its liabilities. As set out in the preceding Financial Overview, the company is not obliged to make payments to capacity providers unless and until it has the funds to do so. The company also applies prudent financial management to ensure that its operating costs are covered by the settlement costs levy.

As part of the strategic planning process, the directors have analysed the regulatory and legal environment in which the company operates and do not foresee any changes that will significantly affect the finances of the company within the period of the three-year plan. The directors have also carefully considered the way in which the company manages its principal risks (which are set out on pages 18 to 21). They do not believe these risks will bring into question the company's viability.

Based on their analysis, the directors have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the relevant period.

Risk management – principal risks

The board formally reviews the material risks facing the company and ensures that they are appropriately managed by the executive team, including ensuring that management is alert to and takes account of any new or emerging risks as the company develops and the electricity market and/or government policy changes and evolves. The board retains ultimate responsibility for the company's risk management framework, with oversight of the overall effectiveness of the risk management programme being delegated to the audit, risk and assurance committee. The company's internal audit function provides further assurance on the effectiveness of the internal controls relating to risk.

The risk management framework has been designed to provide the executive and board with a clear line of sight over risk and to enable informed decision making. It focusses on the identification, management, monitoring and reporting of risk and reviews completion of the primary actions being undertaken to manage and mitigate risk. Risk management is embedded within the company's operational activities. The company has also undertaken in 2017/18 a refreshed review of its risks, including from a "blank sheet" basis.

The company's approach to risk management is designed to provide reasonable, but not absolute assurance that its business is safeguarded, the risks facing the business are being assessed and mitigated and all information that is required to be disclosed to the executive, board and audit, risk and assurance committee is disclosed. The company's approach to risk management is further detailed in the Corporate Governance Report on page 34.

The board considers the matters outlined below are, as at the date of this report, the principal risks and uncertainties that could adversely impact the company's reputation and operations and thus its ability to deliver against its strategic objectives.

Risk or uncertainty	Risk brief description	Main mitigating actions
Settlement services	<p><i>*Actions have been developed by management to mitigate risks towards the target positions</i></p> <p>There is a risk that the system and processes will not effectively deliver settlement services and that the increasing level of settlements will place an unanticipated strain on the system and/or have inadvertent knock on effects. There is also a risk that delays occur in the delivery of ongoing changes to the settlement system or that key processes are not fully designed, documented and fit for purpose or are delayed.</p> <p>Risk appetite – low Target risk rating – medium Current risk rating – high* Recent risk movement – increased due to the volume of change.</p>	<ul style="list-style-type: none"> • All proposed changes are impact assessed • Good project governance is in place • Discussions take place with BEIS, Ofgem and National Grid in relation to Capacity Market policy changes to agree implementation plans to minimise delivery risk to the implementation of system change • All changes in the agreed change programme are impact assessed and implemented on agreed timelines • Working level and executive level meetings with National Grid and the settlement system delivery provider are in place to co-ordinate deliverables involving delivery partners • A controls workshop is held with the settlement system delivery provider to obtain system and controls assurance • Controls assurance performance reporting is in place • Resource is in place to monitor, review and respond to change consultations • Robust testing processes are in place • An IT change assessment board is in place • Governance is in place for project delivery and management. • A simulated system stress event is scheduled.
Knowledge management	<p>There is a risk that the company does not maintain and implement the appropriate knowledge management and knowledge transfer systems and processes.</p> <p>Risk appetite – medium Target risk rating – low Current risk rating – high* Recent risk movement – increased due mainly to the greater volume of data, information and knowledge sources and the strategic focus on moving further toward Centre of Expertise and Trust Advisor which, to be achieved, requires improved knowledge management systems and processes.</p>	<ul style="list-style-type: none"> • A review is being undertaken of data recording and storage as part of an organisational design programme • The information architecture and other recommendations from the review will be implemented.

Stakeholder management

There is a risk that stakeholders feel insufficiently engaged or dissatisfied with their relationship with the company and/or the company fails to communicate effectively with its stakeholders.

Risk appetite – medium
Target risk rating – low
Current risk rating – medium*
Recent risk movement – increased mainly due to the strategic focus on moving further toward Centre of Expertise and Trust Advisor which, to be achieved, requires successful additional stakeholder management implementation.

- A programme of stakeholder engagement is in place, including stakeholder events and workshops
 - A communications plan is in place together with active management of communications interfaces with delivery partners
 - Project specific meetings and communications are in place with delivery partners
 - Regular meetings are in place with the company's shareholder
- There is ongoing monitoring of policy and industry issues and the impact of potential policy and market change is assessed.

LCCC's delivery

There is a risk that LCCC is inadequately resourced and/or does not meet the company's business needs.

Risk appetite – low
Target risk rating – low/medium
Current risk rating – low*
Recent risk movement - static

The company has close oversight of and receives regular reporting on the delivery by LCCC of services for the company and of the financial and risk management and internal controls which LCCC has in place.

Scheme fraud risk

There is a risk of fraudulent activity from individuals or third parties.

Risk appetite – low
Target risk rating – low
Current risk rating – medium*
Recent risk movement - static

- Key finance controls and fraud controls are in place and monitored, including embedded segregation of duties in the finance processes and systems access controls
- A control environment assurance report on the settlement system has been obtained from an external advisor
- A fraud prevention officer is in place
- Compliance and checking processes have been developed against a fraud control matrix
- Fraud awareness and anti-money laundering training has been provided to the settlement services delivery provider
- An internal audit function is in place and internal audit checks are being undertaken
- Metering assurance and inspection regime is in place
- IT security is in place
- A risk framework has been developed with the settlement services delivery provider
- Fraud prevention meetings and liaison with key individuals within partner organisations and managers of other schemes are taking place.

Risk or uncertainty	Risk brief description	Main mitigating actions
Strategic delivery	<p data-bbox="363 215 687 333"><i>*Actions have been developed by management to mitigate risks towards the target positions</i></p> <p data-bbox="363 367 687 577">There is a risk of insufficient focus on the development and implementation of the company's strategy and how it fits within the broader developments within the energy sector.</p> <p data-bbox="363 600 687 719"> Risk appetite – medium Target risk rating – low Current risk rating – medium* Recent risk movement – static </p>	<ul data-bbox="719 367 1409 763" style="list-style-type: none"> • An organisational design project is under way to ensure that the company has an optimal operating model for the future in order to deliver its strategy • Board strategy sessions are in place • Strategy sessions with senior management are in place • Company-wide strategy communication is in place • The strategy is aligned with the business plan • Strategy delivery is a company key performance indicator • Engagement with BEIS and the government is in place, including regular scheduled meetings • Engagement with the wider sector is being expanded.
Change management	<p data-bbox="363 801 699 1283">There is a risk that proposals for change initiated by other bodies (e.g. BEIS, Ofgem or National Grid) may not be identified at a sufficiently early stage to enable the company to address or influence the proposals appropriately; or its responses to proposals may not be adequately taken into account; or the company might not have the capacity (or budget or resources) to address or implement the required changes within the timescales set by the relevant bodies.</p> <p data-bbox="363 1305 699 1429"> Risk appetite – low Target risk rating – low Current risk rating – medium* Recent risk movement – static </p>	<ul data-bbox="719 801 1393 1182" style="list-style-type: none"> • A company business design authority is in place to approve, monitor and assess change • Resource is in place to monitor, review and respond to consultations • Regular change board meetings take place with the relevant bodies and delivery partners • An IT change assessment board is in place • Governance is in place for project delivery and management • The company is reviewing its change management processes as part of its organisational design programme with a view to implementing any recommended refinements.

**Cyber security/
information security**

There is the risk of a cyber security or information security breach, including a breach suffered by the company's critical suppliers.

Risk appetite – low
Target risk rating – low
Current risk rating – medium*
Recent risk movement – static

- Cyber Essentials accreditation has been obtained
 - Plan to obtain ISO 27001 accreditation is being implemented, including the undertaking of a third-party ISO 27001 gap analysis exercise
 - Internal access controls for systems are in place
 - Data protection measures are in place and GDPR implementation was completed in May 2018
 - Ongoing staff training and awareness are in place
 - Information Asset Register to be developed as part of an Information Lifecycle Map and Logical Data model
 - Business Continuity Plan is in place
 - Review being undertaken of mitigating actions and documenting of business recovery processes in relation to a potential cyber security breach.
-

Signed on behalf of the Board



Neil McDermott

Chief Executive

6 June 2018

Board of Directors



Martin Read
Chair



Jim Keohane
Senior Independent Director



Neil McDermott
Chief Executive



Catherine Gan
Chief Finance Officer



Anne Baldock
non-executive director



Tony Bickerstaff
non-executive director



Simon Orebi Gann
non-executive director



David Long
shareholder
nominated director



Tony White
non-executive director

Directors' report

The directors present their annual report on the affairs of the company, together with the financial statements and auditors' report for the year from 1 April 2017 to 31 March 2018. The company's registered number is 8961281.

Board

The board is responsible for the overall strategy and direction of the company. Details of the board's composition are set out on pages 26 to 27 and 32.

Directors and corporate governance

Full details of the directors and corporate governance matters are set out on pages 25 to 35.

Position of the company

Information relating to the strategy and to the development, performance and the future prospects of the company are set out in the Strategic Report and on pages 2 to 9.

Employees

The company does not have any employees.

Environment

Details are set out on page 12 in the Environment Report.

Payment to suppliers

The company pays its suppliers in accordance with the provisions of its contracts with suppliers, subject to compliance by the suppliers with their obligations.

Charitable and political contributions

During the year, the company made no charitable or political contributions.

Results and dividends

The company has prepared its 2017/18 financial statements in accordance with International Financial Reporting Standards ("IFRS"). The audited financial statements for the year ended

31 March 2018 are set out on pages 44 to 58.

The company is a not-for-profit company. The settlement role it performs ensures that the capacity payments it is required to make to capacity providers holding capacity agreements are matched with the levies it collects from suppliers. The company's costs are funded by the settlement costs levy referred to on page 16. The amount of any excess settlement costs levy collected above requirement is refunded to suppliers. This refund is recognised through the financial statements and matched with the income collected. On this basis the financial results for the year reflect a neutral profit position i.e. nil profit-nil loss. Consequently, the company does not pay a dividend.

For a more detailed review of the results for the year and a more detailed explanation of the accounting profit, see the financial statements on pages 44 to 58 and the Strategic Report on pages 16 to 17.

Directors' third party indemnity provisions

The directors have been granted an indemnity against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 2006. Such qualifying third party indemnity remains in force as at the date of approving this Directors' Report.

Going concern

The directors have a reasonable expectation that the company has adequate resources to continue to operate for the foreseeable future. The financial statements therefore continue to be prepared on a going concern basis. The basis of this view is outlined in more detail in note 2.2 to the financial statements.

Directors' responsibilities statement

The directors are responsible for preparing the annual report and financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year.

Under that law the directors have elected to prepare the company financial statements in accordance with IFRS as adopted by the European Union and in accordance with applicable law. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs and profit or loss of the company for that period.

In preparing these financial statements, the directors are required to:

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each of the directors, whose names and functions are described herein, confirms that to the best of his or her knowledge:

- the financial statements, which have been prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets and liabilities, financial position and the profit or loss of the company; and
- the Directors' Report and Strategic Report include a review of the development and performance of the business and the position of the company, together with a description of the principal risks and uncertainties that it faces.

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

The directors consider that the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for the shareholder to assess the company's position, performance, business model and strategy.

Auditors

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

The company's auditors have expressed a willingness to continue in office. A resolution to reappoint them will be proposed at the relevant time.

By order of the board



Claire Williams
Company Secretary

6 June 2018

Corporate Governance report



I am pleased to present our corporate governance report for the year, which describes our board's general approach to corporate governance and how the UK Corporate Governance Code is applied within the company. The board believes that good corporate governance underpins the delivery of the company's strategy and objectives (described in the Strategic Report) and, is committed to ensuring that high standards of corporate governance are maintained throughout the company.

This year we arranged for an externally facilitated review of our performance as a board. Further details of this evaluation are provided below. We also continued to engage with our shareholder and with key delivery partners and the wider industry.

I would like to thank all board members for their dedication and commitment over the year, including Marion King, whose three-year term of office expired in November 2017, and Simon Elliston who left the board in April 2018.

Dr Martin Read CBE, Chair

The company was established by the Secretary of State for Business, Energy and Industrial Strategy to be the Capacity Market settlement body. The Secretary of State is the sole shareholder of the company.

While the company was set up as an operationally independent private law company, it is also a governmental arm's length body that is funded by and manages compulsory levies. Compulsory levies are normally classified as taxation, which effectively means that the company is managing public monies.

The company accordingly, both as a private company and as an entity having responsibilities for the administration of public monies, adopts the highest standards of governance and works to the highest standards of probity. The company recognises the importance of operating with regularity and propriety, the need for effectiveness and prudence in the administration of public resources and the need to secure value for public money. The company also recognises the importance of embedding the seven principles of public life (selflessness, integrity, objectivity, accountability, openness, honesty and leadership) into its culture and operations.⁹

This Corporate Governance Report outlines the company's governance structure and demonstrates how its arrangements align with the guidelines and principles set out in the UK Corporate Governance Code. An explanation is given below where any aspect of the Code has not been fully applied.

The company's activities in the year are described in pages 2 to 11 and in the Strategic Report at pages 13 to 17.

Framework Document

The company's main governing documents are its Articles of Association and its Framework Document. The Framework Document, which establishes the fundamental relationship between the shareholder and the company, is published on the company's website to provide transparency of the relationship.

The Framework Document reflects the basic tenet that functional independence is compatible with financial oversight of an arm's length body by its parent department. The Framework Document makes it clear that the company has day to day operational independence, subject to certain limited exceptions set out in legislation, the company's Articles of Association and in the Framework Document itself. The limitations on

⁹ *The 7 Principles of Public Life*, available at <https://www.gov.uk/government/publications/the-7-principles-of-public-life/the-7-principles-of-public-life-->

the company's independence are those which are either:

- common to government owned entities and necessary to satisfy government and Parliamentary budgeting and accountability requirements; or
- provide the shareholder with specific controls in respect of policy implementation matters which it is the company's responsibility to execute.

The Framework Document recognises that the company is a separate corporate entity and that its governance, and decision making processes, flow through its board, with its executives reporting to that board.

The Framework Document establishes that in carrying out its functions, activities and role the company shall seek to maintain market participants' confidence in the Capacity Market process and minimise costs to consumers. This is known as the "Guiding Principle". The company recognises the importance of this Guiding Principle.

UK Corporate Governance Code

The company is required by the Framework Document to comply with the UK Corporate Governance Code as it applies to small quoted companies (other than Section E relating to relations with shareholders) or specify and explain any non-compliance in its annual report. The board considers that the company has complied in full with the Code, otherwise than as explained in this Corporate Governance Report. Any non-compliance is due to the requirements of the company's shareholder as reflected in company's Articles of Association and the Framework Document.

The company additionally believes that the adoption of the UK Corporate Governance Code is important as a means of recognising and embedding best practice in corporate governance.

Role of the board

The board is committed to ensuring high standards of corporate governance. It accepts that good governance is based on the underlying principles of accountability, transparency, probity and focus on the sustainable success of the company over the longer term.

The board is collectively responsible for the long-term success of the company and is ultimately responsible for its strategy, management, direction and performance. The board sets the company's

strategic aims, ensures that the necessary financial and human resources are in place for the company to meet its objectives, reviews progress towards the achievement of objectives and reviews the performance of management.

The board establishes the values, culture, ethics and standards of the company and sets the framework for prudent and effective controls, which enables risk to be assessed and managed.

The board has delegated authority to its committees to carry out the tasks defined in the committees' terms of reference. The committees are (i) the audit, risk and assurance committee and (ii) the nomination committee. The written terms of reference of both committees are available on the company's website. The board has delegated the day to day management of the company to the Chief Executive.

Composition of the board

The Framework Document and the Articles of Association provide that the shareholder's approval is required for all board appointments. The Framework Document and the Articles of Association also state that the shareholder has the right to appoint the Chair, the Senior Independent Director and up to two shareholder nominated directors.

Martin Read was appointed as Chair on 2 May 2014 (having previously been appointed as Chair designate around March 2014), and reappointed for a further three-year term in March 2017). Jim Keohane was appointed as Senior Independent Director on 2 May 2014 (having previously been appointed as Senior Independent Director designate around March 2014), and reappointed for a further two-year term in March 2017.

The board comprises seven other directors, being currently one shareholder nominated director, four independent non-executive directors, the Chief Executive and the Chief Finance Officer.

The shareholder nominated director is currently David Long (appointed on 27 October 2015), a public servant employed by a government wholly owned company. Until his resignation on 12 April 2018, a second shareholder nominated director, Simon Elliston (a civil servant employed by central government) was a member of the board. Shareholder nominated directors are appointed for the period required by the shareholder.

The four independent non-executive directors at year end (and currently) are Anne Baldock, Tony Bickerstaff, Simon Orebi Gann and Tony White, each being appointed in November 2014 after the consent of the shareholder was obtained in accordance with the Framework

Document and the Articles of Association. The terms of appointment of each such director was extended in November 2017 for a further period of three years, other than Tony White, whose term of appointment was extended for a period of eight months, in view of his planned scheduled retirement from the board.

Neil McDermott, the Chief Executive, was appointed as a director on 22 July 2014 and Catherine Gan, the Chief Finance Officer, was appointed as director effective on 24 April 2017.

An external recruitment consultancy was used in the original appointments of the Chair, the Senior Independent Director and the independent non-executive directors. An external recruitment consultancy was also used in the search for the Chief Executive and Chief Finance Officer. The shareholder nominated directors are civil servants selected by the shareholder. No recruitment consultancy used by the company has any other connection with the company.

The search process for the appointment of the Chair, Senior Independent Director, independent non-executive directors, Chief Executive and Chief Finance Officer was formal, rigorous and transparent and the searches were conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board.

The details of all board members, any changes in the year and attendance at board meetings are listed on pages 32 to 33. All directors, with the exception of the shareholder nominated director, have written terms of appointment. These terms of appointment are available for inspection at the company's registered office during normal business hours.

The Chair was independent on appointment. The board considers all non-executive directors, other than the shareholder nominated directors, to be independent of the company.

The board and its committees have an appropriate, effective and broad balance of skills, experience, independence and knowledge which enables them to discharge their respective duties and responsibilities effectively.

New directors receive an induction programme and additional training that is tailored to their individual needs.

The company maintains a register of directors' interests.

Board changes

Catherine Gan commenced as both CFO and a board director on 24 April 2017, Marion King's three-year term of office expired on 11 November 2017 and Simon Elliston retired as a (shareholder nominated) non-executive director on 12 April 2018.

Board governance

The board meets sufficiently regularly to discharge its duties effectively, generally meeting eight times per year (with additional ad hoc meetings as required). The board met eight times in 2017/18 and also held a separate strategy meeting.

The Chair has held a meeting with the non-executive directors without the executives being present. The non-executive directors, led by the Senior Independent Director, have met without the Chair and executive directors being present.

Details of the directors' interests are recorded in a register maintained by the company and reviewed at least annually by the board. The company has procedures in place to ensure any actual or potential conflicts of interest are appropriately declared and managed. Directors are required to declare any actual or potential conflict of interest to the board and to the Company Secretary.

The board is supplied in a timely manner with the appropriate information of the required quality to enable it to discharge its duties effectively and properly. The Chair, executive directors and Company Secretary have review processes in place to ensure the quality of the information provided to the board and its committees. The board and committees have concluded, after assessing the question as part of their annual evaluation processes, that they were being provided in a timely manner with appropriate information of the required quality. Board members have access to the Company Secretary and also to independent legal advice if appropriately required.

There is a formal schedule of matters specifically reserved to the board. In high level terms, the day to day management of the company is delegated to the Chief Executive and senior management with the matters reserved to the board including:

- setting and approving the company's strategy
- responsibility for the leadership of the company
- approving the financial statements
- approving (subject to shareholder consent) the annual business plan and budget
- monitoring and overseeing risk management, financial reporting and the system of internal control
- oversight of the company's operations
- approving of financial commitments over specified monetary thresholds
- setting the terms of reference for the board committees.

The main roles and responsibilities of the Chair, Chief Executive, Senior Independent Director and non-executive directors are summarised in high level terms below. There is a formal document, approved by the board, setting out the division of responsibilities between the Chair and the Chief Executive.

The Chair:

- provides clear and effective leadership to the board
- is responsible for maintaining high standards of operation and governance
- is responsible for promoting a culture of openness and constructive debate by facilitating the effective contribution of the non-executive directors
- facilitates the effective contribution and encourages the active engagement of all members of the board
- ensures the annual evaluation of the performance of the board, its members and its committees
- ensures constructive relations between the executive and non-executive directors
- speaks on behalf of the board and represents the board to the shareholder
- manages the business of the board, including the board's agenda and ensuring that adequate time is available for the discussion of

all agenda items, in particular, strategic issues

- is responsible for ensuring that the directors receive accurate, timely and clear information.

The Chief Executive:

- fulfils his responsibilities as Accounting Officer¹⁰
- leads the executive team in the day to day running of the company
- makes and executes operational decisions
- implements the strategy agreed by the board
- ensures delivery within the annual budget
- ensures appropriate internal controls and risk management processes are in place
- maintains the appropriate dialogue with the Chair and the board
- facilitates effective communication to the shareholder and external stakeholders, including service providers, industry parties, regulatory bodies and governmental authorities
- ensures the values of the company are embedded within its operations and staff culture.

The Senior Independent Director:

- works alongside the Chair and provides a sounding board for the Chair
- is available as an intermediary to other directors when necessary
- leads the meeting(s) with the other non-executive directors without the Chair being present, including to appraise the performance of the Chair.

Non-executive directors:

- Non-executive directors (including via their activities in relevant committees) ensure that the board fulfils its responsibilities, including in relation to strategy, monitoring the performance of management and satisfying themselves as to the integrity of financial information and that there is in place robust internal controls and a sound system of risk management.

¹⁰ The responsibilities of an Accounting Officer are described in HM Treasury guidance "*Managing Public Money*". They include accountability for the activities of the company, the stewardship of public funds and the extent to which key performance targets and objectives are met.

Board evaluation

The board undertakes an annual formal and rigorous evaluation of its own performance and that of its committees and individual directors. The committees also each separately undertake an annual evaluation process. In 2017/18 the evaluation was undertaken with the assistance of Korn Ferry, an experienced external facilitator.

This evaluation involved a focussed questionnaire and one-to-one discussions. It looked at a variety of areas, including the composition of the board and committees, the support provided to them, the unity of board member support for the focus of the company's strategic model and the fact that the company had moved, having completed its third year of operation, from start up and transitional stage to being an experienced operator.

The Chair has, with the input and assistance from the other directors and the executive management, undertaken an objective and thorough evaluation of the performance of the Senior Independent Director. The non-executive directors, led by the Senior Independent Director, have undertaken an objective and thorough performance evaluation of the Chair, taking into account the views of executive directors.

These evaluations (including the Korn Ferry evaluation) have concluded that the board and the committees are working cohesively and effectively, are performing their role in a proper, good and appropriate manner and that there is strong corporate governance in place. The Korn Ferry evaluation made a small number of suggestions for future focus, including board succession planning (noting the cycle for board retirements) and some ideas for more in-depth exploration at the board's regular strategy session.

The Chair also regularly reviews and agrees with each director their training and development needs, including as part of the evaluation process. The Company Secretary also seeks to identify useful refresher training or industry familiarisation sessions for directors, including briefings on internal expertise areas (such as forecasting and settlement systems), industry developments and compliance matters.

Audit, Risk & Assurance Committee

At year end, the membership of this committee comprised five non-executive directors, namely Tony Bickerstaff (chair), Jim Keohane, Simon Elliston, Simon Orebi Gann and Tony White. Marion King, who was a member of the

committee, retired from both the board and the committee on 11 November 2017. Tony White was appointed to the committee on 13 December 2017 and David Long on 25 April 2018. Simon Elliston resigned from both the board and the committee on 12 April 2018.

The chair of the committee is a qualified accountant with recent and relevant financial experience. The committee is composed of four independent non-executive directors and one shareholder nominated non-executive director. The Framework Document, as permitted by the Articles of Association, requires the committee to include a director nominated by the shareholder.

The committee met four times in the financial year 2017/18, with meetings in May 2017, July 2017, September 2017 and January 2018.

The Chief Executive (as Accounting Officer), Chief Finance Officer, Head of Internal Audit/ Assurance & Risk¹¹, Company Secretary and external auditors attend each meeting. The Accounting Officer, Chief Finance Officer, Head of Internal Audit/Assurance & Risk and the external auditors have access to the chair of the committee outside formal committee meetings. The Head of Internal Audit/Assurance & Risk and the external auditors each separately meet informally with the committee after every scheduled committee meeting.

The main responsibilities of the committee include:

- monitoring the assurance needs of the company in relation to risk, governance and the control framework
- reviewing the company's internal controls (including financial controls) and risk management systems
- monitoring the integrity of the company's financial statements and reviewing and reporting to the board on significant financial reporting issues and judgements
- monitoring the effectiveness of the company's internal audit function
- making recommendations to the board in relation to the appointment, re-appointment and removal of the external auditor and approving the remuneration and terms of engagement of the external auditor

¹¹ The previous Head of Internal Audit resigned from the company in November 2017 to take up a new appointment elsewhere. He was replaced in December 2017 by the new head of this function (whose position title was changed to Head of Assurance & Risk).

- reviewing external auditor independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements
- reporting to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken
- reporting to the board on how it has discharged its responsibilities
- undertaking an evaluation of its own performance.

The committee has reviewed arrangements by which employees are able, in confidence, to raise concerns about possible improprieties in matters of financial reporting or other matters.

The committee applies an external auditor independence policy to safeguard auditor objectivity and independence where the company's auditors have provided non-audit services. The external auditor has not provided any non-audit services in the financial year.

In the financial year, the committee discussed the following matters:

- Review of Financial Performance
- Risk Register Review
- Internal Audit Activity Update
- Status of Significant Accounting Estimates, Judgements and Special Issues
- Annual Report Update: Going Concern & Viability Statement
- External Auditors' Report for 2016/17
- Letters of Representation for 2016/17
- Recommendation of Annual Report and Accounts for 2016/17
- Committee Annual Report to the Board
- Review of Whistleblowing Policy
- Review of Internal Audit Function
- Follow Up on Internal Audit Survey
- Re-Appointment of External Auditors for 2017/18

- Approval of External Audit Fee for 2017/18
- Review of Audit Committee Terms of Reference
- Annual Evaluation of Committee
- Risk Management and Internal Control Framework
- Annual Report Process for 2017/18
- External Audit Plan and Update on Period 9 Work 2017/18
- Business Continuity Planning Update
- Fraud Risk Update.

The minutes of the meeting are circulated to the board.

There were no significant issues considered by the committee in relation to the financial statements in respect of accounting treatments.

The company's main risks and related mitigating actions are set out on pages 18 to 21 of the Strategic Report. There have been no lapses in data security (other than possibly minor or non-significant lapses). There have also been no incidents of whistleblowing.

The re-appointment of the external auditor was approved by the board in October 2017 upon the recommendation of the committee. The committee, in recommending the re-appointment, and the board in approving the re-appointment, took into account the fact that the Framework Document stated the strong presumption that the company would appoint the National Audit Office (NAO) as its auditor and also that shareholder consent was required for the appointment of any external auditor. It also noted the significant benefits of appointing the NAO based on value for money, the potential synergies with BEIS's audit requirements and the NAO's understanding of both the complex environment within which the company would operate and the wider government and public sector context.

The committee assessed the effectiveness of the external audit process and provided its comments on the effectiveness to the external auditor.

Nomination Committee

At year end, the committee comprised Martin Read (chair), Jim Keohane, Anne Baldock, Simon Orebi Gann and Tony White. All were members of the committee throughout the year, other than Jim Keohane who was appointed on 24 October 2017. Marion King was a member of the committee until her retirement from the board and the committee on 11 November 2017. A majority of members of the nomination committee are independent non-executive directors.

The committee met twice during the year, in July and September 2017. No member of the committee attended an agenda item in which they had a personal interest or were discussed or appraised.

The committee's responsibilities include:

- regularly reviewing the structure, size and composition of the board including skills, knowledge, diversity and experience
- reviewing plans for the orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board
- undertaking an evaluation of its own performance.

These matters were discussed by the committee during the course of the year, with particular reference to the:

- composition of the board and balance of skills required

- reduction of the number of non-executive directors from nine to eight and discussion of this proposal with the shareholder
- re-appointment of specific retiring members of the board
- recruitment process for the identification and appointment of a new director to replace retiring directors.

The committee oversaw the search for the Chief Finance Officer (who was appointed as both Chief Finance Officer and director, effective on 24 April 2017).

The committee, in March 2017, agreed that Martin Read (as Chair of the Board and nomination committee), Jim Keohane (the Senior Independent Director) and the Chief Executive should form a subcommittee in relation to the recruitment of a new non-executive director to replace Tony White, who is scheduled to retire from the Board. The remit of the subcommittee included liaison with the external recruitment consultant selected to assist with the process, conducting the shortlisting and interview process and reporting progress back to the nomination committee.

The minutes of meetings are circulated to the board.

Board and committee membership

The table below sets out the dates of appointment of the members to the board and the committees and details of those board members who resigned in year.

2017/18	Role	Board	Audit, Risk & Assurance Committee	Nomination Committee
Anne Baldock	non-executive director	App. 11/11/2014		App. 16/12/2014
Tony Bickerstaff	non-executive director	App. 11/11/2014	App. 16/12/2014	
Simon Elliston	non-executive director	App. 16/12/2015 Res. 12/04/2018	App. 16/12/2015 Res. 12/04/2018	
Catherine Gan	Chief Finance Officer	App.24/04/2017		
Jim Keohane	non-executive director	App. 22/07/2014	App. 16/12/2014	App 24/10/2017
Marion King	non-executive director	App. 11/11/2014 Res. 11/11/2017	App. 16/12/2014 Res. 11/11/2017	App. 16/12/2014 Res. 11/11/2017
David Long	non-executive director	App. 27/10/2015		
Neil McDermott	Chief Executive	App. 22/07/2014		
Simon Orebi Gann	non-executive director	App. 11/11/2014	App. 16/12/2014	App. 16/12/2014
Martin Read	Chair	App. 22/07/2014		App. 16/12/2014
Tony White	non-executive director	App. 11/11/2014	App. 13/12/2017	App. 16/12/2014

Board and committee meetings

The table below shows the number of board and committee meetings of the company held during the year ended 31 March 2018, and the attendance of the individual directors. All directors are expected to attend all board meetings and all members of committees are expected to attend all committee meetings.

It should be emphasised that the table does not fully reflect the contribution made to the company's business by many of the directors who have also attended other meetings (including with senior managers and/or for briefings on various matters), addressing matters raised ex-committee and attending events relating to the company's business and activities during the year. In addition, generally members who could not attend a meeting provided comments on the papers for the meeting.

Member attendance record

	Board	Audit, Risk & Assurance Committee	Nomination Committee
Number of meetings	8	4	2
Anne Baldock	8		2
Tony Bickerstaff	8	4	
Simon Elliston	8	4	
Catherine Gan	8	(attends but not a member)	
Jim Keohane	8	4	0**
Marion King*	2	1	0
David Long	8		
Neil McDermott	8	(attends but not a member)	
Simon Orebi Gann	8	4	2
Martin Read	8		2
Tony White	7	1**	2

* Resigned part way through the year

**Appointed part way through the year

Relations with shareholder and other stakeholders

The company in accordance with its Framework Document maintains an appropriately regular dialogue with its shareholder. There is one shareholder nominated director (currently reduced from two shareholder nominated directors, due to the resignation of Simon Elliston on 12 April 2018).

The company has also engaged in regular communication with industry and other stakeholders, including by stakeholder engagement events, annual stakeholder survey, regular newsletters and via its website.

As a non-traded entity the company does not propose to have an annual general meeting.

Maintenance of a sound system of internal control

The board has overall responsibility for the company's risk management and system of internal controls and for reviewing their effectiveness. While retaining overall responsibility, the board has established a clear organisational structure and well defined delegated accountabilities for more regular and granular review of the effectiveness of the company's risk management framework to the audit, assurance and risk committee and executive.

The key elements and procedures established to provide effective risk management and internal controls have been established. The systems in place are monitored and embedded and are as set out over the page:

Control and assurance environment

- The board is responsible for the company's system of internal control and for reviewing its effectiveness. The company's system of internal control is designed to manage and where possible to mitigate the risks facing the company, safeguard the assets and provide reasonable (although not absolute) assurance against material financial misstatement or loss. The audit, risk and assurance committee assists the board in discharging its responsibilities (as further described below and in the section headed Audit, Risk and Assurance Committee on pages 29 to 30).
- The board, with the assistance of the audit, risk and assurance committee, has reviewed and is satisfied with the effectiveness of the company's systems of risk management and internal control. There have been no significant lapses in protective security.
- There is an appropriate quality assurance framework in place and applied to all business critical models.

Risk management framework

- The identification, mitigation and continual monitoring of significant business risks is the responsibility of senior management. Each functional department of the company maintains a risk register identifying the business risks and allocating responsibility for appropriate monitoring and the implementation of mitigating controls. Departmental risk registers and the company's strategic risk register are kept under regular review by the senior management team and reported to the board and audit, risk and assurance committee, with the top strategic risks receiving particular attention. A risk workshop attended by senior employees was held during the year. Risk management processes are incorporated into the company's management and governance systems at all levels and form a part of the company's day to day operations.
- The audit, risk and assurance committee formally reviews the risk position at each scheduled meeting (in 2017/18, in May 2017, July 2017, September 2017 and January 2018) and is updated on any significant risk matter which falls outside its formal review cycle. The committee considers the risk appetite of the company in relation to the principal risks and receives a completion report relating to the actions being undertaken to minimise and mitigate risk items.
- The board reviews the strategic risk register twice per year (in 2017/18, in July and December 2017). The reports to the audit, risk and assurance committee and the board

include a report from management on the status of the risk management and internal control, (if any) any significant failings or weaknesses identified during the period and (if relevant) any actions taken to remedy any significant weaknesses.

- The board has reviewed, with the assistance of the audit, risk and assurance committee, and is satisfied that a comprehensive and robust process for identifying, assessing and managing the company's principal risks is in place, including in respect of those risks that would threaten its business model, future performance, solvency or liquidity. Reference is made to the more detailed risk report on pages 17 to 21.

Internal audit

- The company has an internal audit function that provides the audit, risk and assurance committee with independent, objective assurance regarding internal controls and the risk management process as part of the company's risk management and assurance regime. The audit, risk and assurance committee agrees a programme of internal audit work annually and reviews progress at each of its meetings. The annual audit plan takes into account current business risks. The focus of internal audit during 2017/18 moved from a programme based on functional internal audits to audit work in relation to significant end to end processes and whether the key controls in those processes are operating effectively.

Financial management and reporting

- There is a comprehensive strategic planning, budgeting and forecasting process within the company, with the business plan (including the annual budget) being approved by the board.
- The company's operational costs are set out in the annual budget. The process for establishing the annual budget involves a number of stages which provide challenge and accountability to ensure that a robust and prudent annual budget is prepared which also ensures cost control and value for money for consumers. The draft budget is reviewed by the board, subsequent to which it is submitted to the shareholder for further review. The shareholder then undertakes a public consultation on the proposed budget. Subsequently the settlement costs levy, which funds the company's budget, is laid before Parliament in the form of regulations.
- The company operates robust financial management processes to ensure that it manages within its operational budget so as not to exceed the settlement costs levy.

- An update on the company's progress, forecasts and results is reported in the management information report submitted to each board meeting.
- Senior management meet regularly with the Chief Executive and Chief Finance Officer to discuss business progress and review management accounts.
- There is shareholder oversight of financial management as set out in the Framework Document and the Finance and Reporting Letter from the shareholder to the company dated 1 August 2014, including monthly reporting.
- The company is required to comply with the requirements set out in the Framework Document and the Finance and Reporting Letter, including the requirement to comply with the relevant requirements in HM Treasury guidance entitled "*Managing Public Money*"¹².

Operational

- The senior management team meets on a weekly basis to review the operations of the company, its delivery, progress, issues and challenges. The Chief Executive has regular meetings with each member of the senior executive team.
- The Chief Executive and the executive team meet with appropriate regularity with the shareholder and other stakeholders.
- The settlement team and other functional teams work closely together to ensure the appropriate interfaces and communication in relation to capacity agreement settlement and metering assurance, with the governance, internal decision making and critical processes being documented.
- The company reports on its significant matters relating to its operational activities at each board meeting.
- The board decides on matters falling within the schedule of reserved matters (e.g. financial commitments over the specified threshold) or otherwise raised to it for decision.

Procurement

- The company has in place an effective procurement policy and is required to procure all goods and services in compliance with the relevant requirements in *Managing Public*

Money, certain Cabinet Office controls and the public procurement regulations.

- The company is required to carry out procurement and project appraisal objectively and fairly, using cost benefit analysis and generally seeking good value for money.

Legal and compliance

- There is a system for monitoring and embedding compliance, including by company policies and procedures as well as training and guidance to support compliance (e.g. relating to anti-bribery, whistle-blowing, anti-money laundering, health & safety and other legislative and good practice requirements). External obligations are driven primarily by key legal, statutory and regulatory requirements.
- The company expects the highest standards from all employees and delivery partners.
- The company considers and implements the requirements of the Alexander Tax Review in relation to the retention of consultants.¹³

Treasury management

- The finance department:
 - operates within policies agreed by the audit, risk and assurance committee
 - uses its resources efficiently, economically and effectively, avoiding waste and extravagance
 - uses management information systems to gain assurance about value for money and the quality of delivery and so make timely adjustments; and
 - uses internal and external audit to improve its internal controls and performance.

Insurance

- Appropriate insurance is in place, with insurance cover being reviewed annually by the board.



Neil McDermott

Chief Executive and Accounting Officer
6 June 2018

¹² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/454191/Managing_Public_Money_AA_v2_-jan15.pdf

¹³ HM Treasury, Review of tax arrangements of public sector appointees, May 2012: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220745/tax_pay_appointees_review_230512.pdf

Remuneration report

Employees

The company (registered no. 8961281) does not have any employees. The company performs its functions through LCCC.

Executive directors

The executive directors are employed and paid by LCCC. They therefore do not receive any remuneration from the company. LCCC charges the company for its services, with an amount relating to full cost of the executive directors to LCCC forming a fair and properly allocated component of that charge. This arrangement is detailed in the “recharge” arrangements described in note 2.6 to the financial statements.

Non-executive director fees

The shareholder nominated (or “governmental”) directors are not paid by the company.

Levels of remuneration for the remunerated non-executive directors reflect the time, commitment and responsibilities of the role and the advice on remuneration for directors and benchmarking information provided, at time of their original appointments in 2014, by Odgers Berndtson (an independent recruitment consultancy).

No director is involved in deciding his or her own individual remuneration.

For reasons of synergy, operational efficiency and cost effectiveness, the board of directors of the company and LCCC are identical. As the fees paid to the remunerated non-executive directors relate to work for both companies, these fees are paid by LCCC, with a fair and properly allocated amount (generally 20%) being “recharged” by LCCC to the company under the “recharge” arrangements described in note 2.6 to the financial statements. This allocation is illustrated in the table below. These fees (paid by LCCC with the relevant recharge to the company) are the only form of remuneration received by the remunerated non-executive directors.

Non-executive Directors' Remuneration (audited).

Name	2017/18 Fees £	Principal positions held elsewhere at 31 March 2018
Anne Baldock	20% of £25,000 2016/17: 20% of 25,000	<ul style="list-style-type: none"> • ESC – non-executive director • Bazalgette Tunnel Limited – non-executive director
Tony Bickerstaff	20% of £31,000 2016/17: 20% of £31,000	<ul style="list-style-type: none"> • Costain Group Plc – Group Finance Director • CBI Economic Growth Board – member • LCCC – non-executive director
Catherine Gan	N/a – see above	<ul style="list-style-type: none"> • LCCC – Chief Finance Officer and director
Simon Elliston	0 (shareholder nominated director – civil servant)	<ul style="list-style-type: none"> • Director of Finance and Commercial – BEIS (resigned from this post subsequent to year end) • LCCC – non-executive director
Jim Keohane	20% of £40,000 2016/17: 20% of £40,000	<ul style="list-style-type: none"> • Harwich Haven Authority – chair • Market Operator Services Ltd - chair • LCCC – non-executive director
Marion King (ret.)	20% of £15,353 2016/17: 20% of £25,000	<ul style="list-style-type: none"> • Royal Bank of Scotland – Group Director of Payments • Payments UK – director
David Long	0 (shareholder nominated director – public servant)	<ul style="list-style-type: none"> • UK Government Investments – Executive Director • BIS (Postal Services Act 2011) Company Ltd – non-executive director • LCCC – non-executive director
Neil McDermott	N/A – see above	<ul style="list-style-type: none"> • LCCC – Chief Executive and director
Simon Orebi Gann	20% of £25,000 2016/17: 20% of £25,000	<ul style="list-style-type: none"> • LCCC – non executive director • Aspen Technology Inc (NASDAQ: AZPN) – USA – non-executive director • Market Operator Services Ltd – non-executive director • Treasury/Cabinet Office Major Programmes Review Group – independent panel member
Martin Read	£24,000 2016/17: £24,000	<ul style="list-style-type: none"> • Laird plc – chair • Remuneration Consultants Group – chair • LCCC – chair • UK Government Senior Salaries Review Body – chair • Lloyds of London (Franchise Board) – non-executive director • Hampshire Technology Centre Trust - trustee
Tony White	20% of £25,000 2016/17: 20% of £25,000	<ul style="list-style-type: none"> • LCCC non-executive director • Green Energy Options – non-executive director • The Ecofin Research Foundation – trustee director • BW Energy Ltd – director • First Utility Trust – trustee • Sark Electricity Price Control Commissioner

Independent Auditor's Report to the sole shareholder of the Electricity Settlements Company Limited

Opinion on financial statements

I have audited the financial statements of the Electricity Settlements Company Limited ("the company") for the year ended 31 March 2018 which comprise:

- the Statement of Comprehensive Income;
- the Statement of Financial Position;
- the Statement of Cash Flows;
- the Statement of Changes in Equity; and
- the related notes, including the significant accounting policies.

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006. I have also audited the information in the Directors' Remuneration Report that is described as having been audited.

In my opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2018 and of the result for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and

- have been prepared in accordance with the Companies Act 2006.

Opinion on regularity

In my opinion, in all material respects the expenditure and income recorded in the financial statements have been applied by the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Basis of opinions

I conducted my audit in accordance with International Standards on Auditing (ISAs) (UK) and Practice Note 10 'Audit of Financial Statements of Public Sector Entities in the United Kingdom'. My responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of my report. Those standards require me and my staff to comply with the Financial Reporting Council's Revised Ethical Standard 2016. I am independent of the company in accordance with the ethical requirements that are relevant to my audit and the financial statements in the UK. My staff and I have fulfilled our other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

The regularity framework described in the table below has been applied:

Regularity Framework

Authorising legislation	<ul style="list-style-type: none"> • Energy Act 2013 • Companies Act 2006 • Articles of Association
Parliamentary authorities	<ul style="list-style-type: none"> • Capacity Market Rules
Shareholder, HM Treasury and related authorities	<ul style="list-style-type: none"> • Framework Document between the Secretary of State and the company • Managing Public Money • Cabinet Office spending controls (to the extent they are applicable to the company)

Overview of my audit approach

Key audit matters

Key audit matters are those matters that, in my professional judgment, were of most significance in my audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that I identified.

I consider the following areas of particular audit focus to be those areas that had the greatest effect on my overall audit strategy, the allocation of resources in my audit and directing the efforts of the audit team in the current year. These matters were addressed in the context of my audit of the financial statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters.

This is not a complete list of all risks identified by my audit but only those areas that had the greatest effect on my overall audit strategy, allocation of resources and direction of effort. I have not, for example, included information relating to the work I have performed around the presumed risk of management override of controls under International Standard on Auditing (UK) 240, the Auditor's Responsibility Relating to Fraud in Financial Statements, an area where my work has not identified any matters to report.

The areas of focus were discussed with the Audit, Risk and Assurance Committee; their report on matters that they considered to be significant to the financial statements is set out on page 30.

Key audit matter

My response and findings

Capacity Market payments

As explained in note 2.5 to the financial statements, payments are made to registered capacity market participants based upon their committed capacity and the relevant auction clearing price. Whilst I did not identify a significant risk of material misstatement or irregularity associated with the payments, they were an area of focus for my audit on the basis that 2017-18 was the first full year of Capacity Market payments, and that certain features of the scheme were operated for the first time during the year.

I obtained a detailed understanding of the basis on which Capacity Market payments are made, and the factors which affect the amounts to be paid, and used this information to construct my own expectation for Capacity Market expenditure.

The financial statements recognise Capacity Market payments of £221million for the year to 31 March 2018 (31 March 2017: £9million) which is in line with the expectation I generated. Accordingly I am satisfied that Capacity Market payments are appropriately recorded in the financial statements.

Application of materiality

I applied the concept of materiality in both planning and performing my audit, and in evaluating the effect of misstatements on my audit and on the financial statements. This approach recognises that financial statements are rarely absolutely correct, and that an audit is designed to provide reasonable, rather than absolute, assurance that the financial statements are free from material misstatement or irregularity. A matter is material if its omission or misstatement would, in the judgement of the auditor, reasonably influence the decisions of users of the financial statements.

Based on my professional judgement, I have continued to set overall financial statement materiality at 2% of the company's gross expenditure. Accordingly, I have determined overall financial statement materiality to be £4.5million. This is higher than the quantitative threshold I set in the prior year due to the growth

in Capacity Market payments made by the company during the year.

As well as quantitative materiality there are certain matters that, by their very nature, would if not corrected influence the decisions of users. For example, any errors reported in Directors' Remuneration or any errors in operational costs that would have resulted in the company reporting an overspend against its operational budget. Assessment of such matters would need to have regard to the nature of the misstatement and the applicable legal and reporting framework, as well as the size of the misstatement.

I applied the same concept of materiality to my audit of regularity. In planning and performing audit work in support of my opinion on regularity and evaluating the impact of any irregular transactions, I took into account both quantitative and qualitative aspects that I consider would reasonably influence the decisions of users of the financial statements.

I agreed with the Audit, Risk and Assurance Committee that I would report to it all uncorrected misstatements identified through my audit in excess of £90,000, as well as differences below this threshold that in my view warranted reporting on qualitative grounds.

There were no unadjusted errors to report to the Audit, Risk and Assurance Committee.

Responsibilities of the Directors for the financial statements

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for:

- the preparation of the financial statements and for being satisfied that they give a true and fair view;
- such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
- assessing the company's ability to continue as a going concern, disclosing, if applicable, matters relating to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (ISAs) (UK).

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when

it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs (UK), I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control.
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the entity to cease to continue as a going concern.

- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

In addition, I am required to obtain evidence sufficient to give reasonable assurance that the income and expenditure reported in the financial statements have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Audit scope

The scope of my audit was determined by obtaining an understanding of the entity and its environment, including entity-wide controls, and assessing the risks of material misstatement at the entity level.

Other Information

Directors are responsible for the other information. The other information comprises information included in the annual report, other than the parts of the Remuneration Report described in that report as having been audited, the financial statements and my auditor's report thereon. My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon. In connection with my audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

I am specifically required to address the following items and to report uncorrected material misstatements of the other information where I conclude that those items do not meet the following conditions:

- Fair, balanced and understandable: the statement given by the directors that the annual report and accounts taken as a whole are fair, balanced and understandable and provide the necessary information to enable users to assess the entity's performance, business model and strategy, is materially consistent with my knowledge obtained in the audit; or
- Audit, Risk and Assurance Committee reporting: the section describing the work of the company's Audit, Risk and Assurance Committee appropriately addresses matters communicated by me to the Audit, Risk and Assurance Committee.

I also have nothing to report in this regard.

Opinion on other matters prescribed by the Companies Act

Directors' remuneration

In my opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

I also report to you if, in my opinion, certain disclosures of directors' remuneration required have not been made. I have nothing to report arising from this duty.

The strategic and directors' reports

In my opinion, based on the work undertaken in the course of the audit, the information given in the Strategic and Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements and those reports have been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, I have not identified any material misstatements in the Strategic Report or the Directors' Report.

The corporate governance report

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

- the information given in the corporate governance report, in compliance with rules 7.2.5 and 7.2.6 in the Disclosure Rules and Transparency Rules sourcebook made by Financial Conduct Authority (the FCA Rules), in respect of internal control and risk management systems in relation to financial reporting processes, and about share capital structures, is consistent with the accounts and has been prepared in accordance with applicable legal requirements.
- rules 7.2.2, 7.2.3 and 7.2.7 of the FCA Rules about the company's corporate governance code and practices and about its administrative, management and supervisory bodies and their committees have been complied with.

Based on my knowledge and understanding of the company and its environment obtained during the course of the audit, I have identified no material misstatements in this information.

Matters on which I report by exception

Adequacy of accounting records information and explanations received

I report to you if, in my opinion:

- adequate accounting records have not been kept, or returns adequate for my audit have not been received from branches not visited by my staff;
- the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made;
- I have not received all of the information and explanations I require for my audit; or
- a corporate governance statement has not been prepared by the company.

I have nothing to report arising from this duty.

Conclusions relating to principal risks, going concern and viability statement

Under International Standards on Auditing (UK), I am required to report to you if I have anything material to add, or to draw attention to, in relation to the directors' disclosures in the annual report and financial statements:

- confirming that they have carried out a robust assessment of principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity;
- describing those risks and explaining how they are being managed or mitigated;
- on whether they considered it appropriate to adopt the going concern basis, and their identification of any material uncertainties to the entity's ability to continue over a period of at least twelve months from the date of approval of the financial statements; and
- explaining how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

I have nothing material to add, or to draw attention to, on these matters.



Susan Clark
Senior Statutory Auditor

For and on behalf of the
Comptroller and Auditor General (Statutory
Auditor)

National Audit Office
157-197 Buckingham Palace Road
London, SW1W 9SP

7 June 2018

Financial statement and notes to the accounts

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Statement of comprehensive income for the year ended 31 March

	Note	2018 £'000	2017 £'000
Other income	6	226,281	12,875
Other operating costs	7	(226,281)	(12,875)
Profit for the year		-	-
Other comprehensive income for the year		-	-
Total comprehensive income for the year		-	-

All operations are continuing operations.

The notes on pages 50 to 58 form part of these accounts.

Statement of financial position

as at 31 March

	Note	2018 £'000	2017 £'000
Non-current assets			
Intangible assets	8	1,779	2,290
Current assets			
Levy receivable from electricity suppliers	9	344	24
Prepayments and other receivables	10	21	801
Cash and cash equivalents	11	126,977	34,295
Total current assets		127,342	35,120
Total assets		129,121	37,410
Current liabilities			
Levy and capacity payments payable	12	(73,349)	(7,160)
Trade and other payables	13	(53,951)	(27,919)
Borrowings	14	(3)	(3)
Finance lease obligations	15	(507)	(507)
Total current liabilities		(127,810)	(35,589)
Non-current liabilities			
Finance lease obligations	15	(1,307)	(1,814)
Borrowings	14	(4)	(7)
Total non-current liabilities		(1,311)	(1,821)
Total liabilities		(129,121)	(37,410)
Net assets		-	-
Shareholders' equity and other reserves			
Share capital	16	-	-
Retained earnings		-	-
Total equity		-	-

The notes on pages 50 to 58 form part of these accounts.

The financial statements were approved by the board of directors on 6 June 2018 and signed on its behalf by:



Neil McDermott
Chief Executive Officer



Catherine Gan
Chief Finance Officer

Statement of changes in equity for the year ended 31 March

	Share capital £'000	Retained earnings £'000	Total equity £'000
As at 31 March 2016	-	-	-
Share capital issued	-	-	-
Total comprehensive income for the year	-	-	-
As at 31 March 2017	-	-	-
Share capital issued	-	-	-
Total comprehensive income for the year	-	-	-
As at 31 March 2018	-	-	-

As at 31 March 2018 the company has one authorised ordinary share issued and fully paid.
The notes on pages 50 to 58 form part of these accounts.

Statement of cash flows for the year ended 31 March

	Note	2018 £'000	2017 £'000
Cash flows from operating activities			
Profit for the year		–	–
Adjustment to reconcile profit before tax to net cash flows:			
Amortisation of intangible assets	8	511	261
Working capital adjustments:			
(Increase)/decrease in receivable from electricity suppliers	9	(320)	(21)
(Increase)/decrease in prepayments and other receivables	10	780	(603)
Increase in levy and capacity payments payable	12	66,189	5,815
Increase in trade and other payables	13	26,032	22,977
Net cash inflow from operating activities		93,192	28,429
Cash flows from investing activities			
Purchase of intangible assets	8	–	–
Net cash outflow from investing activities		–	–
Cash flows from financing activities			
Decrease in borrowings	14	(3)	(5)
Repayment of finance lease obligations	15	(507)	(217)
Net cash outflow from financing activities		(510)	(222)
Net increase in cash and cash equivalents in the year		92,682	28,207
Cash and cash equivalents at the beginning of the year		34,295	6,088
Cash and cash equivalents at the end of the year	11	126,977	34,295

The notes on pages 50 to 58 form part of these accounts.

Notes to the financial statements for the year ended 31 March 2018

1. Authorisation of financial statements

The financial statements of Electricity Settlements Company Ltd (the “company”) for the year ended 31 March 2018 were approved and authorised for issue in accordance with a resolution of the directors on 6 June 2018.

The company is a company limited by shares, incorporated and domiciled in the UK. The company’s registered office is at Fleetbank House, 2-6 Salisbury Square, EC4Y 8JX. The company is unlisted and wholly owned by the Secretary of State for Business, Energy and Industrial Strategy (the “shareholder”) making it the company’s ultimate controlling party.

1.1 Principal activities

The company has been established to act as the settlement body for the Capacity Market. The company will also undertake such other activities that the board considers to be consistent with the company’s functions, duties, obligations and constitution.

2. Accounting policies

2.1 Basis of preparation

These financial statements are presented in pounds sterling and all values are rounded to the nearest thousand pounds (£’000).

The financial statements of the company have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and applied in accordance with the provisions of the Companies Act 2006 applicable to companies reporting under IFRS.

These accounts have been prepared under the historical cost convention as modified for the treatment of financial instruments.

The Capacity Regulations as identified below are defined hereafter as the “Regulations”:

- i. The Electricity Capacity Regulations 2014 as amended
- ii. The Electricity Capacity (Supplier Payment etc.) Regulations 2014 as amended.

2.2 Going concern

The directors have a reasonable expectation that the company has adequate resources to continue to operate for the foreseeable future. The financial statements are, therefore, prepared on a going concern basis.

In forming this view, the directors note that the company:

- i. applies prudent financial management in order to ensure that its commitments are accommodated within the timing of its collection of its settlement costs levy;
- ii. undertakes a robust and detailed annual business planning and budgeting process to establish its operational costs requirements for each financial year;
- iii. has considered the potential impact of credit risk and liquidity risk detailed in note 3; and
- iv. is exposed to minimal cash flow risk through Capacity Market transactions as a result of the statutory ‘pay when paid’ mechanism explained in note 2.4.

The day to day operational costs of the company are funded by electricity suppliers under the Capacity Market “settlement costs levy” which is set by the Regulations.

The settlement costs levy is reset by new amending regulations and has currently been set for the next three years (to March 2021).

The directors note the risk that the total settlement costs levy set for a year will be insufficient or that a timing mismatch might arise between the time when monies are raised by the levy and the time when monies are required to meet a spend commitment made by the company.

During the course of a year, the company may, where it identifies that there is likely to be a shortfall in the collection of the settlement costs levy against its requirements, request BEIS to support an in-year adjustment to the applicable levy rate. Such an adjustment would be subject to public consultation and the making of new regulations in accordance with the same process that has applied to the setting of the

annual settlement costs levy. The company can also request a working capital loan from BEIS if there is a shortfall in its operating cash flow.

The requirement to pay capacity payments to capacity providers is set out in the Regulations. The payments to be made to capacity providers are funded by suppliers under the Regulations. It should be noted that the Regulations state that the company's obligation is to pay when paid (i.e. the company has no obligation to pay the capacity providers until it receives adequate funds from suppliers to perform its obligation).

2.3 Settlement costs levy income

Under the Regulations, the company is entitled to recover its operational costs through the settlement costs levy on suppliers referred to above. The total amount of the levy has been set for the next three years. Any surplus at the year end is reimbursed to suppliers by issuing credit notes against the following year's levy and is classified as part of levy and capacity payments under current liabilities.

Settlement costs levy income is recognised as 'other income' in the financial year to which it relates and is presented net of any settlement costs levy repayable to suppliers.

The settlement costs levy is collected through monthly invoices. The settlement services provider, EMRS, administers the collection process.

2.4 Capacity Market supplier charge income

Capacity Market supplier charge income relates to the charges which electricity suppliers are required to pay under the regulations to meet the cost of funding capacity payments. Under the Regulations, the company is entitled to collect the Capacity Market supplier charge before making capacity payments. The total amount of the Capacity Market supplier charge is set before the start of the delivery year based on suppliers' forecasts. The Capacity Market supplier charge is re-determined in monthly and yearly reconciliations. Re-determination of the Capacity Market supplier charge takes the following into account:

- i. Transition from forecast to actual meter data; and
- ii. Adjustments to capacity payments payable.

Any surplus Capacity Market supplier charge at the year end is classified as part of levy and capacity payments under current liabilities.

2.5 Capacity payments

Capacity payments are payments to the capacity providers under the Regulations for their commitment to meet a capacity obligation

during a delivery year. Total capacity payments are based on the capacity cleared price achieved in the auction in respect of which the capacity agreement was awarded. Capacity payments are split into 12 monthly payments which are weighted to reflect the seasonal variation of electricity demand in Great Britain during a year.

Following a transmission system stress event, capacity providers may be eligible for additional payments or subject to financial penalties, depending on whether they exceed their capacity obligations (over-deliver) or fail to meet them (under-deliver).

2.6 Recharges

The company is recharged a proportion of costs which it shares with Low Carbon Contracts Company Ltd (LCCC). LCCC is a sister arm's length body owned by the Secretary of State for Business, Energy and Industrial Strategy and is responsible for acting as the counterparty to Contracts for Difference (CFDs). In order to maximise operational cost efficiency, LCCC provides certain services to the company and makes certain payments on its behalf. Typically this includes common costs such as staff costs, shared IT infrastructure and the use of shared resources and facilities. The recharge also includes costs incurred on those activities that allow the company to perform its functions in relation to the Capacity Market.

This recharge is based on an estimate of the time LCCC's employees will spend on the company's activities during the relevant financial year, together with an appropriate allocation of overhead costs (including rent, service charge, IT infrastructure and telephony support) and a 'use of asset' charge. It also includes a proportion of the salaries of the board members who divide their time between the two companies. LCCC undertakes these activities on behalf of the company and the company's board retains responsibility and accountability for the quality and cost of services provided by LCCC.

The company and LCCC are part of the same VAT group, therefore no VAT is charged on costs recharged by LCCC. The company's income is outside the scope of VAT so it will be unable to recover its input VAT on any of its expenditure.

2.7 Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the company will comply with all the attached conditions.

The interest free capital loan received by the company from BEIS for capital expenditure is recognised under borrowings and is repayable

over the useful life of the assets funded through this loan. The benefit of a below-market rate of interest on the capital loan for capital expenditure, if material, is recognised in the statement of comprehensive income over the period of the loan.

2.8 Financial assets

The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition. Management determines the categorisation of financial assets at initial recognition and re-evaluates this designation at each reporting date.

The only financial assets held by the company at the reporting date are other receivables and cash and cash equivalents.

Cash and cash equivalents comprise cash held at bank and are subject to an insignificant change in value.

2.9 Financial liabilities

The company classifies financial liabilities as 'other financial liabilities'. Other financial liabilities include trade and other payables, borrowings and finance lease obligations.

The categorisation depends on the purpose for which the financial liability is held or acquired. Management determines the categorisation of financial liabilities at initial recognition and re-evaluates this designation at each reporting date.

2.9.1 Recognition and measurement

Other financial liabilities are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortised cost using the effective interest rate method, with interest expense recognised on an effective yield basis.

2.9.2 Derecognition of financial liabilities

Financial liabilities are derecognised when, and only when, the obligations are discharged, cancelled or they expire.

2.10 Intangible assets

Intangible assets are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses (if any). Intangible assets have finite lives and are amortised over their useful economic life, assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period.

Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are considered to modify the amortisation period or method, as appropriate, and are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the statement of comprehensive income in the expense category that is consistent with the function of the intangible assets.

Intangible assets are amortised over the following period:

	Years
Settlement System	5
Other IT software	5

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the statement of comprehensive income when the asset is derecognised.

2.11 Impairment of non-financial assets

Intangible assets are only subject to amortisation to the extent that they are available for use. Intangible assets, which are not available for use, are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. At each reporting date, the company reviews the carrying amounts of its 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 any impairment loss.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are largely independent cash inflows (cash-generating units). Impairment losses are charged to the statement of comprehensive income and prior impairments of non-financial assets are reviewed for possible reversal at each reporting date.

2.12 Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at the inception of the lease.

The arrangement is, or contains, a lease if fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset or assets, even if that right is not explicitly specified in an arrangement.

A lease is classified at the inception date as a finance lease or an operating lease. Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

2.12.1 Finance leases

Company as a lessee

The lease of the settlement system where the company has substantially all the risks and rewards of ownership is classified as a finance lease. Finance leases are capitalised at commencement of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments. The present value of the minimum lease payments of the settlement system approximates to its fair value.

The settlement system acquired under a finance lease is amortised over the shorter of the useful life of the asset and the lease term.

2.13 Provisions

Provisions are recognised when the company has a present obligation (legal or constructive) as a result of a past event, that can be reliably measured, and it is probable that an outflow of economic benefits will be required to settle that obligation.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation. The accounting policy allows for an increase in the provision due to the passage of time (time value of money) which would be recognised as an interest expense.

2.14 Segmental reporting

The company operates solely within the UK and within one business segment; hence no segmental reporting is required. This is consistent with the internal reporting provided to the directors of the company, who are considered the company's chief operating decision makers.

2.15 Borrowings

Borrowings represent a grant in aid capital loan from BEIS. Borrowings are recognised initially at fair value, net of transaction costs incurred (if any). Borrowings are subsequently carried at amortised cost; any difference between the proceeds (net of transactions costs, if any)

and the redemption value is recognised in the statement of comprehensive income over the period of the borrowings using the effective interest method.

2.16 Bid bond collateral

In order to enter Capacity Market auctions, applicants must lodge bid bond collateral with the company where, on Prequalification Results Day, those applicants receive a notice from National Grid, as transmission System Operator that states Prequalification of their Capacity Market Unit(s) is conditional on providing bid bond collateral.

Bid bond collateral will be held by the company until one of the following triggers set out in the Regulations occurs:

- the relevant Capacity Market auction is delayed;
- the potential capacity provider notifies that it no longer intends to bid in the relevant Capacity Market auction;
- the Capacity Market auction takes place and the potential capacity provider does not win a capacity agreement; or
- the capacity provider demonstrates capacity in the manner required by the Regulations.

Bid bond collateral may not be returned to the capacity providers if the capacity agreement is terminated.

When a capacity agreement is terminated either a termination fee becomes payable or bid bond collateral is drawn down. These amounts are passed onto the Government's Consolidated Fund via BEIS and are not included in the statement of comprehensive income.

3. Financial risk management

3.1 Financial risk management and financial risk factors

Due to the nature of its operational and financial arrangements the company is not exposed to any significant financial risk. The financial risk is minimal by virtue of the company's levy funding arrangements with licensed suppliers, which are set out below.

3.2 Credit and liquidity risk

Under the legislation there is an obligation placed on licensed suppliers to fund in advance, via payment through a levy, the capacity payment obligations as they crystallise. The company has no obligation to pay the capacity providers until it receives adequate funds from suppliers to perform its obligations.

As the Capacity Market settlement timetable is structured such that monies to be received by the company are invoiced and collected prior to the issue of credit notes and payments out from the company, the liquidity risk is minimal.

4. Critical accounting judgements, estimates and assumptions

The preparation of the company's financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and other factors, including expectations or future events that are believed to be reasonable under the circumstances. The results form the basis of making judgements about carrying values of assets and liabilities that are not readily apparent from other sources.

Revisions to accounting estimates are recognised in the period in which the estimate is revised, if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

4.1 Estimates

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below. The company based its assumptions and estimates on parameters available when the financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising that are beyond the control of the company. Such changes are reflected in the assumptions when they occur.

4.1.1 Estimating useful lives and residual values of Intangible assets

At each reporting date, the useful lives and residual values of intangible assets are reviewed. Assessing the appropriateness of useful life and residual value estimates requires the company to consider a number of factors such as the technological advancement, expected period of use of the asset by the company, and expected disposal proceeds (if any) from the future sale of the asset. An incorrect estimate of the useful life or residual value will affect the amortisation expense recognised in the statement of comprehensive income and the asset's carrying amount.

4.2 Significant judgement

Management has made the following judgement in applying the company's accounting policy.

4.2.1 Capacity agreements

Capacity agreements are arrangements between National Grid (as System Operator) and capacity providers. They require the capacity provider to be ready to provide a certain amount of capacity in their applicable delivery years when called upon to do so by National Grid.

The company is not party to capacity agreements but is only responsible for acting as an administrator for the settlement process. A Capacity Market obligation for the company only arises when settlement levy payments are received from electricity suppliers (i.e. only pay when paid) and the capacity provider delivers the required capacity in line with the capacity arrangements. As a result no provision is raised in the statement of financial position and capacity agreements are not classified as financial instruments because the company's role is driven by statute rather than contract.

4.2.2 Valuation of intangible assets

See financial overview on pages 16 to 17.

5. New standards, amendments and interpretations not yet adopted

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the company's financial statements are disclosed below. The company intends to adopt these standards, if applicable, when they become effective. The company has not sought early adoption of any standards or amendments. The company has reviewed the impact of these standards. None of these standards, except IFRS 16: Leases, are expected to have a significant effect on the financial statements of the company. Once IFRS 16 is adopted, the operating lease for the office rental will be capitalised.

IFRS 9: Financial instruments

IFRS 9, "Financial instruments", addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued in July 2014. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. The standard is effective for accounting periods beginning on or after 1 January 2018.

IFRS 15: Revenue from Contracts with Customers

IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15 revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The standard is effective for accounting periods beginning on or after 1 January 2018. The company has assessed and judged that IFRS 15 does not apply to income from electricity suppliers. ESC will continue to apply its accounting policy which follows the IFRS Conceptual Framework for Financial Reporting.

IFRS 16: Leases

IFRS 16 was issued in January 2016 and establishes principles for the recognition, measurement, presentation and disclosure of leases.

The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less, or the underlying asset has a low value. The standard is effective for accounting periods beginning on or after 1 January 2019.

Any impact on ESC would relate to the premises lease of the office, which is subject to the recharge arrangement which is referred to in note 2.6.

There are no other IFRS or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the company.

6. Other income

	2018	2017
	£'000	£'000
Settlement costs levy income	6,244	4,283
Less: amount repayable to suppliers	(706)	(1,373)
Net settlement costs levy income	5,538	2,910
Capacity Market supplier charge income	220,743	9,199
Settlement system dispute	–	766
Other income	226,281	12,875

The delivery year for the Capacity Market runs from October 1st to September 30th of each year. 2017/18 saw the first full Capacity Market delivery year. The capacity payments for each delivery year are summarised in the table below:

Capacity Market Delivery	2017/18	2016/17
Transitional Arrangements 2016/2017 (October 2016 to September 2017)	£7.4m	£9.2m
Transitional Arrangements 2017/2018 (October 2017 to September 2018)	£7.2m	–
Early Capacity Auction 2017/2018 (October 2017 to September 2018)	£206.1m	–

7. Other operating costs

	2018	2017
	£'000	£'000
Capacity payments	220,743	9,199
Operational settlement costs	2,925	1,606
Costs recharged by LCCC	1,628	1,707
Amortisation	511	261
Legal, professional and consultancy	370	–
Insurance	64	65
Auditor's remuneration	35	30
Miscellaneous costs	5	7
Other operating costs	226,281	12,875

8. Intangible assets

	Settlement System £'000	Other IT Software £'000	Total £'000
Cost			
As at 31 March 2016	1,533	15	1,548
Additions during the year	1,005	–	1,005
As at 31 March 2017	2,538	15	2,553
Additions during the year	–	–	–
As at 31 March 2018	2,538	15	2,553
Amortisation			
As at 31 March 2016	–	2	2
Charge for the year	258	3	261
As at 31 March 2017	258	5	263
Charge for the year	508	3	511
As at 31 March 2018	766	8	774
Net book value as at 31 March 2017	2,280	10	2,290
Net book value as at 31 March 2018	1,772	7	1,779

The company leases the settlement system from BEIS under a finance lease where all the risks and rewards of ownership rest with the company. The settlement system went live in September 2016. The lease term is 5 years which is the period over which the asset will be depreciated.

As the settlement system asset is matched with the associated finance lease obligations, so asset additions during the year are matched with an equivalent increase in the lease obligation and are therefore treated as non-cash transactions in the preparation of the statement of cash flows.

9. Levy receivable from electricity suppliers

	2018 £'000	2017 £'000
Settlement costs levy	337	3
Capacity Market supplier charge	7	21
	344	24

10. Prepayments and other receivables

	2018 £'000	2017 £'000
Amounts owed by LCCC	–	766
Prepayments	21	21
Other receivables	–	14
Total prepayments and other receivables	21	801

Prepayments comprise the insurance charge and software maintenance support relating to the next financial year, 2018/19, which has been paid in advance.

11. Cash and cash equivalents

	2018 £'000	2017 £'000
Cash at bank	73,169	6,392
Suppliers' credit cover	6,538	1,046
Bid bond collateral	47,270	26,857
Total cash and cash equivalents	126,977	34,295

For the purpose of the statement of cash flows, cash and cash equivalents only comprise of cash at bank, suppliers credit cover and bid bond collateral as stated above. Suppliers credit cover and bid bond collateral is a restricted cash balance and relates to credit cover provided by the capacity providers and electricity suppliers. No interest is earned on suppliers' credit cover and interest earned on bid bond collateral is returned to the capacity providers.

12. Levy and capacity payments payables

	2018 £'000	2017 £'000
Capacity payments	70,031	2,826
Settlement costs levy	1,044	1,573
Capacity Market supplier charge	2,274	2,761
Total levy and capacity payments	73,349	7,160

Capacity payments payable are the amount due to the capacity providers under the Regulations for their commitment to meet a capacity obligation during a delivery year. Total capacity payments are based on the capacity cleared price achieved in the auction that the capacity agreement was awarded.

The settlement costs levy payable relates to the difference between the operational costs which have been collected from electricity suppliers during 2017/18, based on estimated spend for the year, and the operational costs actually incurred during the year. The difference is refunded to suppliers in the following financial year.

The supplier charge payable relates to the difference between Capacity Market supplier charges which have been collected from electricity suppliers during 2017/18, based on estimated payments to the capacity providers, and the actual payments made during the year. The difference is refunded to suppliers in the following financial year.

13. Trade and other payables

	2018 £'000	2017 £'000
Bid bond collateral	47,267	26,858
Suppliers' collateral	6,538	1,046
Accruals and other payables	146	15
Total trade and other payables	53,951	27,919

Bid bond collateral relates to credit cover provided by the capacity providers.

14. Borrowings

	2018 £'000	2017 £'000
Current		
Grant in aid capital loan	3	3
Non-current:		
Grant in aid capital loan	4	7
Total borrowings	7	10

The grant in aid capital loan is interest free and repayable to BEIS from funding received through the settlement costs levy collected from suppliers. The timing of the repayment of the loan is in line with the depreciation charged on the assets funded via the loan.

15. Finance lease obligations

	£'000
As at 31 March 2016	1,533
Finance lease acquired during the year	1,005
Repayment of finance lease obligations	(217)
As at 31 March 2017	2,321
Repayment of finance lease obligations	(507)
As at 31 March 2018	1,814

	2018 £'000	2017 £'000
Less than 1 year	507	507
Between 1 and 5 years	1,307	1,814
As at 31 March	1,814	2,321

The finance lease obligation is held in respect of the settlement system asset which has been funded by BEIS through EMRS, a wholly owned subsidiary of ELEXON Ltd.

16. Share capital

	Number
Authorised shares	
Ordinary share capital £1 each	1
	£
Ordinary share capital issued and fully paid:	
As at 31 March 2016	1
Ordinary share capital issued during the year	–
As at 31 March 2017	1
Share capital issued during the year	–
As at 31 March 2018	1

17. Related-party transactions

The following table provides the total amount of transactions that have been entered into with related parties for the relevant financial year.

	Services from related parties £'000	Amounts owed by related parties £'000	Amounts owed to related parties £'000
Entities with significant influence:			
2017			
LCCC	1,707	766	–
BEIS	1,005	–	2,331
2018			
LCCC	1,628	–	–
BEIS	–	–	1,890

Services from LCCC comprise shared costs of premises, staff and directors' payroll costs, IT infrastructure and use of assets which are incurred in the first instance by LCCC but are then recharged to the company based on the estimated usage of those services. Services received from BEIS relate to the receipt of the settlement system in the form of a finance lease arrangement (see note 15).

18. Financial assets and liabilities

Financial assets

	Note	2018 £'000	2017 £'000
Cash and cash equivalents	11	126,977	34,295
Other receivables	10	–	780
Total financial assets		126,977	35,075

Financial liabilities

	Note	2018 £'000	2017 £'000
Trade and other payables	13	53,951	27,919
Borrowings	14	7	10
Finance lease obligations	15	1,814	2,321
Total financial liabilities		55,772	30,250
Total current		54,461	28,429
Total non-current		1,311	1,821
Total financial liabilities		55,772	30,250

19. Events after the reporting period

There are no post balance sheet events which have a material impact on the company's financial results.

Glossary

BSC	Balancing and Settlement Code (BSC)* is a legal document which defines the rules and governance for the balancing mechanism and imbalance settlement processes in respect of the wholesale electricity market in Great Britain. (* https://www.elexon.co.uk/bsc-related-documents/)
BEIS	Department for Business, Energy and Industrial Strategy.
capacity agreement	A capacity agreement is a regulatory and rule based arrangement between National Grid, as System Operator, and a successful applicant in a Capacity Market auction. The capacity agreement provides a regular retainer payment to the successful applicant or “capacity provider”.
Capacity Auction	At a Capacity Auction, applicants who offer the lowest bid can win a capacity agreement. A Capacity Auction relates to delivery of capacity approximately four years ahead (T-4). For instance, the capacity agreements resulting from the 2014 T-4 Capacity Auction will require capacity to be delivered in the Delivery Year commencing 2018/19. Most recently, the capacity agreements resulting from the 2017 T-4 Capacity Auction, held in February 2018, are for the Delivery Year commencing in 2021/22. Also, the capacity agreements resulting from the 2017 T-1 Capacity Auction, held in January 2018, are for the Delivery Year commencing in 2019/20. The interim periods are covered by Transitional Arrangements.
Capacity Market	The Capacity Market has been designed by BEIS to offer capacity providers who have been awarded capacity agreements via auctions with a revenue stream, with the aim of ensuring they are available to contribute to security of supply at least cost to consumers.
capacity provider	A capacity provider is the holder of a capacity agreement with National Grid (as System Operator). Capacity providers can be new or existing generators, electricity storage providers and significant users of electricity who provide voluntary demand side reductions (Demand Side Response). Capacity providers provide capacity under either a capacity agreement resulting from a Capacity Auction, or from a Transitional Arrangements Auction.
Contracts for Difference or CFDs	A CFD awarded under the CFD scheme is a long term agreement between a low carbon electricity generator and LCCC. It is designed to provide the generator with a stable pre-agreed price (the “strike price”) for the lifetime of the contract. This is done by paying the difference where electricity prices are less than the strike price (and receiving the difference when prices are higher than the strike price).
Delivery Year	This is a defined term within the Capacity Market Rules referring to each obligation period of a capacity agreement being 1 October to 31 March of the following year.
Demand Side Response	Demand Side Response helps to manage the demand for electricity. It involves changing the usage patterns of electricity users (the “demand side”) in response to incentives. It is used to match supply with demand when unpredictable fluctuations occur and provides a mechanism through which demand can be reduced in peak times when system capacity is tight, thereby minimising the amount of additional generation capacity being brought onto the grid. Demand Side Response is seen as having the potential to help to lower consumer bills, electricity system costs and carbon emissions produced by traditional peaking plant, such as oil, coal and gas-fired generation.

EMRS	EMR Settlement Ltd (EMRS) is a wholly owned subsidiary of ELEXON Ltd and is the settlement services provider to ESC and LCCC. The parties have entered into a contract under which EMRS will provide settlement services (including billing, collection and settlement) and provide and manage the operation of the settlement system. (EMRS website: https://www.emrs.co.uk/)
LCCC	Low Carbon Contracts Company Ltd (LCCC) is the counterparty to CFDs and manages them over their lifetime. It is a sister company to ESC.
meter assurance	Under the Capacity Market, capacity providers with complex or non-BSC metering arrangements need to undergo metering checks in accordance with ESC meter standards guidance. (https://www.electricitysettlementscompany.uk/)
Ofgem	Office of Gas and Electricity Markets, a non-ministerial government department and an independent national regulator.
Obligation Trading	Also commonly referred to as “Secondary Trading”, this allows capacity providers to trade all or part of their Capacity Market capacity obligation for a Delivery Year with other eligible Capacity Market participants who meet the ‘acceptable transferee’ requirements. It enables capacity providers to cover periods of unavailability of capacity due to planned and unplanned outages of generators and Demand Side Response participants, enabling the transfer of the risk of under delivery, which would otherwise ordinarily attract capacity penalty payments.
Secondary Trading	See “Obligation Trading”.
settlement system	The settlement system used to settle all monies collected from suppliers to make payments to CFD generators and Capacity Market providers, and to settle all monies collected from CFD generators and Capacity Market providers which are payable to suppliers or (in the case of the Capacity Market) BEIS.
System Operator	Organisation licensed by Ofgem to operate the GB electricity system, a role currently held by National Grid Plc. The electricity SO’s current responsibilities include balancing the electricity system, running electricity capacity auctions, coordinating and administering aspects of industry rules and codes and supporting efficient transmission network development.
Transitional Arrangements	Transitional Arrangements were introduced by BEIS to support participation of potential Demand Side Response providers and generating units of less than 50MW in the Capacity Market during the interim period prior to 2018/19, which is the delivery year relating to the first Capacity Auction. In other words, the arrangements are designed to support the development of this sector in the run up to the Capacity Market being in full operation. Transitional Arrangements Auctions are year ahead held, with capacity agreements being given to successful applicants.
Transitional Arrangements Auctions	Transitional Arrangements Auctions are one year ahead auctions under the Transitional Arrangements.
Volume Reallocation	In addition to Obligation Trading, Capacity Market participants will be able to re-allocate excess capacity arising from the over-delivery of capacity during a transmission system stress event, to other Capacity Market participants who have under-delivered (during a transmission system stress event). This is to incentivise delivery and support the respective flow of payments. This short- term trading measure is referred to as Volume Reallocation.



Neil McDermott
Chief Executive



Catherine Gan
Chief Finance Officer



Ruth Herbert
Head of Strategy
& External Relations

**Senior
Management
Team**



Claire Williams
Head of Legal &
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