

National Grid Electricity System
Operator Limited

Annual Report and Accounts 2020/21

Registered in England and Wales
Number 11014226

nationalgridESO

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Foreword from our Chair

Welcome to the Annual Report and Accounts 2020/21 for the National Grid Electricity System Operator (ESO).

The last year has been shaped by the Covid-19 pandemic, which has deeply impacted all of us and the communities we operate in. For the ESO, the pandemic brought about unique operational challenges – both what we do and how we do it. I am pleased at the incredible resilience shown by my colleagues who have managed the many demands of the last year admirably while continuing to deliver fantastic service for our customers and consumers.

Our swift response to the pandemic, based on the implementation of well-developed crisis response plans, enabled us to move quickly to new ways of working. Many colleagues have now spent a whole year away from the office, while those in the control room have seen significant changes to their office environment. As we start to return to the office, we want to capture what we have learnt about the value of flexibility and digital collaboration over the last year.

On the operational side, the pandemic presented us with challenges throughout the summer of 2020. Lower demands for electricity made the grid harder to operate. To address this, we introduced a new Optional Downward Flexibility Management service, giving us access to flexibility from distributed generators we previously could not contract with. We also entered into a contract with EDF Energy to reduce the output of Sizewell B for a fixed period of time.

While the costs of operating the system over spring and summer 2020 were higher than previous years, the demands and challenges were unprecedented and we took every opportunity to ensure that all our actions were efficient and in the best interests of consumers.

2020 was the greenest year ever for Britain's electricity. Between April and June 2020, we went for almost 68 days without running any coal power stations and the number of coal free hours increased by 40% compared to 2019. This demonstrates the progress we are making towards our ambition to be able to operate the electricity grid carbon free by 2025.

Over the last year we saw broad discussion on the industry roles required for net zero and the extent to which institutional governance and frameworks may need to evolve. I was pleased to see Ofgem publish their review of system operation and we continue to engage with them and the Department for Business, Energy and Industrial Strategy (BEIS) on this important topic.

2020 also saw the ESO launch some strategic initiatives to drive change in the electricity sector. Our work on Early Competition, Offshore Coordination, and Future Markets will put competition and efficiency at the heart of the electricity sector, helping to ensure that we protect consumers and communities. You can read more about these projects in the Report.

Finally, the year has seen changes to the Board and the Executive Team. John Linwood and Regina Moran both joined the Board as Non-Executive Directors in the year and bring a wealth of Technology, Engineering and Commercial experience. Gregg Smith joined the Board in the year as Finance Director. In the Executive Team Isabelle Haigh joined as the new Head of National Control, Norma Dove-Edwin as the new Chief Information Officer and Matthew Wright as the new Head of Strategy and Regulation. All four executives bring great skills and experience and will help the ESO deliver on its ambitions.



Fintan Slye

Fintan Slye

Chair, Electricity System Operator

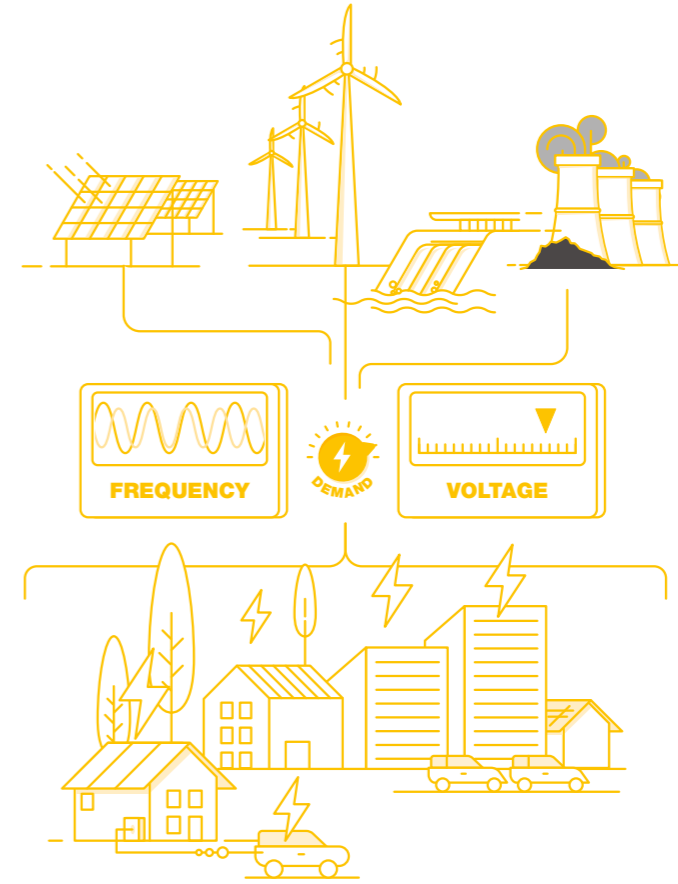
National Grid Electricity System Operator Limited
1-3 Strand, London WC2N 5EH
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About National Grid Electricity System Operator

Our role

Electricity is the life blood of society and the economy. When someone flicks a light switch in their home or office, they know the light will come on. That, in a nutshell, sums up our primary responsibility. We run the high voltage electricity wires that keep the UK's homes and businesses supplied with the electricity they rely on day in, day out. We make sure that Britain has the energy it needs by making sure supply meets demand every second of every day.



To achieve this we perform three core roles:

- 1** Control Centre Operations: reliable, secure system operation, to deliver electricity when consumers need it.
- 2** Market development and transactions: transforming participation in smart and sustainable markets.
- 3** System insight, planning and network development: unlocking consumer value through competition and driving towards a sustainable, whole energy future.

You can learn more about these roles, and how we will deliver them in our [Business Plan here](#).

Our mission, vision and values

Our Mission /

Our mission is to enable the transformation to a sustainable energy system and make sure that reliable, affordable energy is delivered for all consumers.

This includes preparing Britain's electricity system to be able to run on purely zero-carbon electricity by 2025.

Over the last five years, we're proud to say the amount of carbon-based electricity in our system has reduced by an impressive 53%. But there's still plenty more to do before we reach our zero-carbon target.



Our Ambition /

One of our ambitions is to be able to run a carbon free electricity system by 2025, which will be crucial in helping the UK meet its wider net-zero target. Achieving this will make us the first system operator to transition away from a system dependent on fossil fuels, to one that can be operated safely using only zero-carbon generation sources.

To help us achieve our mission, we have set clear goals for 2025:

- An electricity system that can operate carbon free;
- A whole system strategy that supports net-zero by 2050;
- Competition everywhere; and
- The ESO is a trusted partner.

Our Values

We know that how we deliver is as important as what we deliver. If our mission sets out ‘what’ we want to achieve, our values are the ‘how’. They help shape what guides us.

We adapt and develop our values to align with the expectations of our customers and communities, without losing sight of the things that make us strong today.

Every day we do the right thing by:

- Keeping each other and the public safe, complying with all relevant rules, regulations and policies;
- Respecting our colleagues, customers and communities; and
- Saying what we think and challenging constructively.

Every day we find a better way by:

- Delivering excellent performance for our customers;
- Sharing knowledge and implementing best practices for continuous improvement; and
- Embracing opportunities to grow ourselves and the business.

We make it happen by:

- Delivering positive outcomes and achieving results;
- Making decisions in a timely way; and
- Getting things done efficiently.



Who we are - Board

Fintan Slye
Chair of the Board



Fintan is the Executive Director of the ESO and Chair of the Board. Prior to that he was Chief Executive of the EirGrid Group, the electricity system and market operator in Ireland and Northern Ireland.

Hannah Nixon
Independent Non-Executive Director



Hannah is experienced in economic regulation across a range of industries. She was the inaugural CEO of the Payment Systems Regulator and a senior partner at Ofgem, having responsibility for the networks division. Hannah is currently a NED of Thames Water and an advisor to Curve, a fintech company. In June 2021 Hannah was appointed as NED for the Financial Reporting Council (FRC) Board. Appointments to the FRC Board are made by the Department for Business, Energy and Industrial Strategy.

Baroness Gillian Merron
Independent Non-Executive Director



Baroness Merron of Lincoln is a Life Peer and Shadow Minister for Health and the Department of Culture, Media and Sports. Formerly, Chief Executive of the Board of Deputies of British Jews, she was the MP for Lincoln between 1997 and 2010. During this time, Baroness Merron served in government as a Minister in the Health, International Development, and Transport departments as well as in the Cabinet and Foreign Offices.

Paul Plummer
Independent Non-Executive Director



Paul is an experienced business leader and strategic thinker now working as an academic, NED and mentor. He was recently appointed Professor in Rail Strategy at the University of Birmingham. Prior to that he was CEO of the Rail Delivery Group, and on the Board of Network Rail. His earlier career spanned regulated utilities as an economist and adviser working for governments, companies and regulators.

John Linwood
Independent Non-Executive Director



John has held senior technology roles in Microsoft and Yahoo and was formerly Chief Technology Officer at several companies including BBC and Wood Mackenzie. John has been a Non-Executive Director of both FTSE and AIM listed companies since 2012 and is currently on the Board of Brooks Macdonald, an AIM listed Wealth Management company.

Regina Moran
Independent Non-Executive Director



Regina is an experienced CEO and Non-Executive Director. She is Vice President of Strategic Projects and Change with Fujitsu. Formerly CEO of Fujitsu UK and Ireland, she has extensive experience in digital transformation across a number of different sectors. She has served as President of Engineers Ireland and as a Non-Executive Director of EirGrid.

Kayte O'Neill
Head of Markets



Kayte is Head of Markets for the ESO, having joined National Grid in 2002. She has previously held positions in Corporate Strategy and Regulation in the US for National Grid. Kayte is a Non-Executive Director at Regen, a not-for-profit centre of energy expertise and insight whose mission is to transform energy systems for a zero carbon future.

Gregg Smith
Finance Director



Gregg is Finance Director for the ESO, having joined in 2020 after 21 years with IMI plc. He is a qualified Chartered Management Accountant (ACMA and CGMA) and has held several global roles across all three IMI divisions throughout his career.

Zoe Morrissey
Non-board: ESO Legal Counsel and Company Secretary



Zoe joined National Grid in 2012 and has worked across various UK business units. Prior to that she worked for Ofwat and in private practice in the competition and procurement team. Zoe qualified as a solicitor in 2008.

Who we are - Executive

Fintan Slye
Executive Director



Kayte O'Neill
Head of Markets



Gregg Smith
Finance Director



Isabelle Haigh
Head of National Control



Matthew Wright
Head of Strategy and Regulation



Isabelle joined ESO in March 2021 from Gas Transmission where she was heading up the operational field force. She graduated in Electrical and Electronic Engineering and has worked in the industry for 30 years. Previous roles have included; being the first female engineer in the Birmingham Grid Centre, and leading large transformation projects such as the development of the Transmission Network Control Centre.

Matthew is Head of Strategy and Regulation, having joined the ESO in April 2021. He has over 30 years of experience in the utilities sector, most recently as Managing Director of Ørsted in the UK. Matthew has also served as CEO of Southern Water and EVP of Power Delivery at US electric utility PacifiCorp. He is a Board member of POWERful Women, a professional initiative to advance gender diversity within the energy sector.

Julian Leslie
Head of Networks and Chief Engineer



Julian is Head of Networks and Chief Engineer for National Grid Electricity System Operator. He previously held a position as Head of National Control for National Grid UK. He is a Chartered Engineer and a fellow of the Institute of Engineering and Technology.

Huma Ali
Senior HR Business Partner



Huma is the Senior HR Business Partner for the ESO, she joined National Grid in 1990. Previous roles include Senior HR Business Partner to other Group business units. She is a chartered member of the Institute of Personnel and Development. Huma is a lead mentor in Business in the Community for diverse senior leaders.

Norma Dove-Edwin
Chief Information Officer



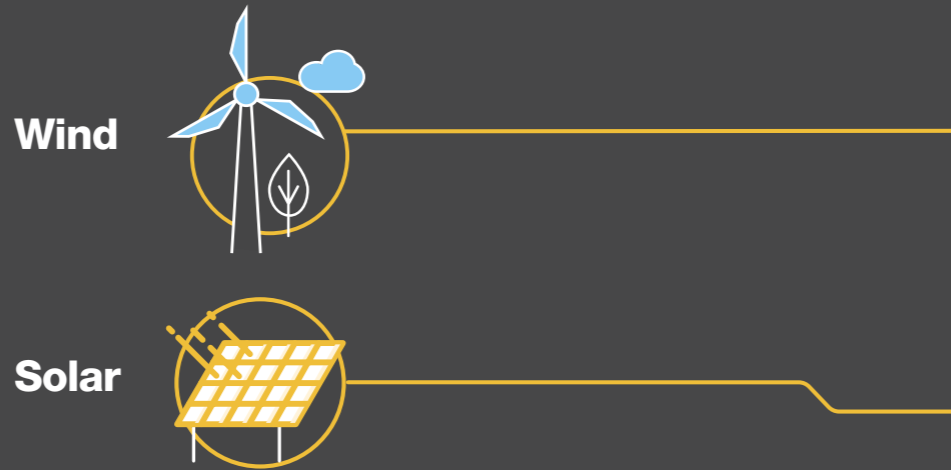
Norma is Chief Information Officer for the ESO. Prior to joining the ESO in November 2020, Norma was Group Chief Information and Data Officer at Places for People, where she led their digital transformation. Norma spent nine years at British American Tobacco where she held a series of executive roles. She has an MBA from Imperial College, London.

Jonny Gallagher
Head of Corporate Affairs



Jonny is Head of Corporate Affairs for the ESO, he joined the ESO in 2019. He has previously worked for National Grid Ventures in regulatory, policy and business development roles focussing on electricity interconnection. Prior to this he worked as a Civil Servant in a variety of policy roles.

The Year In Review Key statistics

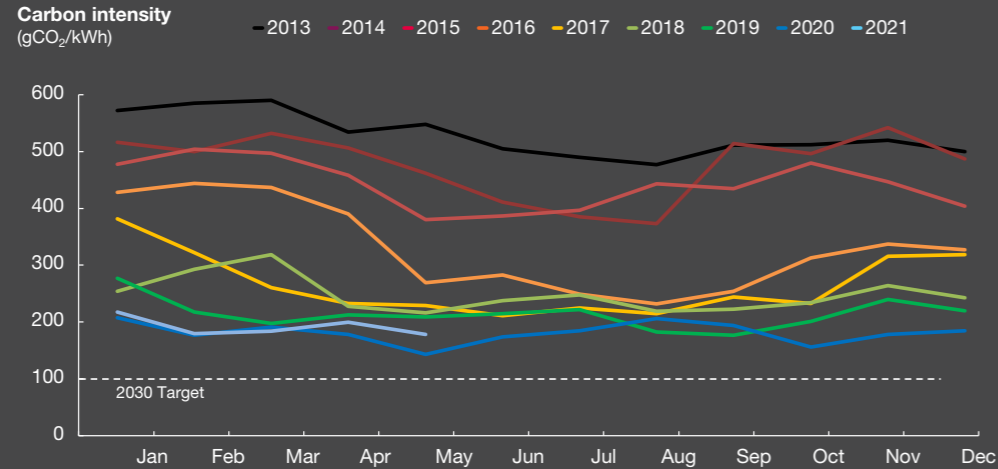


In the period, blustery conditions on 13 February 2021 saw wind power set a new record level electricity **generation of 17.5 GW, meeting 43%** of Great Britain's electricity demand at that time. However 21 May 2021 has since seen this record broken, with 17.8 GW of wind power produced (63% of Great Britain's needs at the time).

Sunny spells in April 2020 brought us the **highest ever level of solar powered electricity** generation in Britain, with output in one half-hour period on 20 April peaking at **9.68 GW**.

Carbon intensity

On 24 May 2020 we saw the lowest ever carbon intensity in a half-hour period on the electricity system at **46 gCO₂/kWh**. However, 5 April 2021 set an even lower record at just **39 gCO₂/kWh**. In addition, **May 2020 was the greenest month in history**, with a record month low carbon intensity figure on average of just 143 gCO₂/kWh.



↓ **65.8% decrease** from 2013 to 2021

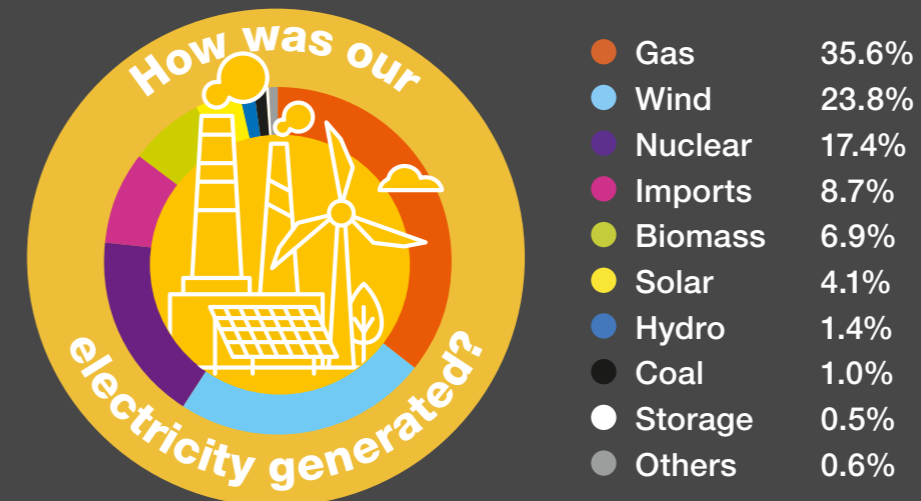
2013 529 gCO ₂ /kWh	2018 248 gCO ₂ /kWh
2014 477 gCO ₂ /kWh	2019 215 gCO ₂ /kWh
2015 443 gCO ₂ /kWh	2020 181 gCO ₂ /kWh
2016 330 gCO ₂ /kWh	2021 188 gCO ₂ /kWh*
2017 266 gCO ₂ /kWh	*year to date

Generation mix

Zero carbon (wind, nuclear, solar and hydro) sources continue to make up a growing share of electricity generation.

On average they contributed **47%** across the year. The **largest % zero carbon share was 82.5%** coming at 1.30pm on the 23 May 2020.

By 2025 it's our ambition, when the market presents enough zero carbon generation, to **make it possible to be able to operate the system at 100% zero carbon**.

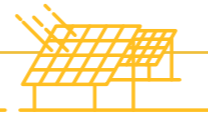


Role 1 On A Page: Control Centre Operations



What we do

The Control Centre moves electricity around the country second by second to ensure that the right amount of electricity is where it's needed, when it's needed – always keeping supply and demand in perfect balance. Our control room employees move high voltage electricity from where it's generated, such as a wind farm, through the energy system to ensure it can be used as required. This service continues every day as we work tirelessly to operate a safe, reliable and affordable electricity system. We have all sorts of engineers and experts working in the Control Centre from people who forecast the weather to those who monitor the frequency of our electricity to ensure it stays within 50 Hz.



What have Control Centre Operations achieved for consumers?

- We improved our systems to enable wind power to be used for response services through a project that went live in 2020/21 called Power Available Phase 2 (saving consumers approximately £1.5m per year);
- We continued to enable Balancing Mechanism participation for smaller parties, increasing competition which should lower prices and lead to lower balancing costs than would otherwise be the case;
- We trialled a new tool in 2020/21 with NewGrid to optimise the energy network to relieve constraints, called Transmission Network Topology Optimisation, using recommendations from an algorithm to reconfigure our network (saving consumers up to £65m per year).

Control Centre Operations Plan Delivery in 2020/21

- Reacted quickly to the Covid-19 pandemic: ensuring colleague safety, and security of supply, and deferring charges to protect our customers;
- Improved transparency for stakeholders via the weekly ESO transparency forum and meeting commitments in our transparency roadmap;
- Completed all Platform for Energy Forecasting deliverables, to develop and implement state of art forecasting capability which delivers value to the end consumer by providing more accurate, user-friendly, comprehensive forecasts to our stakeholders to make informed decisions ahead of real-time;
- Transparent coverage of winter margin challenges, driving increased clarity in the industry;
- In September 2020, the new Wider Access Application Programming Interface (API) went live in the control room. Non-traditional

market participants will be able to use it to join the Balancing Mechanism through a more simple, cost-effect and web based route;

- Worked closely with interconnector stakeholders for IFA2 commissioning, delivering the second connection between France and Great Britain, which can provide us with access to a large volume of low CO₂ energy;
- Technology Advisory Council (TAC) formed to guide digital, data and technological transformation.

Control Centre Operations Performance:

To view our success against performance metrics and key indicators please see Role 1 content in the ESO End of Year Performance Report [here](#).

Role 2 On A Page: Market Development and Transactions



What we do

One of our ambitions is to see competition everywhere, and at the ESO we are continuously developing the market to ensure we can meet the nation's diverse needs both now and in the future. We're continually finding ways to innovate and adapt electricity markets to keep supply flowing reliably to homes and businesses across Great Britain. Our teams are identifying and developing the necessary market and auction platforms to procure the balancing services we require to operate the system - now and in the future. This will deliver value for money for consumers. The team also administers a number of differing codes on behalf of the industry including the Grid Code, CUSC and STC codes.



What have Market Development and Transactions achieved for consumers?

- Our Frequency Risk and Control Report (FRCR) set out clear, objective criteria to balance cost and risk to ensure the consumer receives efficient security of supply and reduced supply risks via the Dynamic Containment project and Accelerated Loss of Mains Change programme. We anticipate spending £244m on frequency control in 2021/22 compared with £275m-£360m in previous years;
- Streamlined Grid Code governance and modification to remove blockers to the energy transition;
- Trialled the use of Reserve from Storage with an approximate value of £0.7m this year and significant future consumer benefits from the experience gained.

Market Development and Transaction Plan Delivery in 2020/21

- Progressed urgent activities as a result of the low demands associated with the Covid-19 lockdown, such as new services and necessary code modifications;
- Working closely with industry on reactive reform, the Power Potential project is a world first, and could save consumers over £400m by 2050 and generate up to an additional 4GW in the South East region of the UK. We have teamed up with UK Power Networks to launch this initiative which aims to create a new reactive power market for distributed energy resources and generate additional capacity on the network;
- Clearly set out our plans via the ESO Markets Roadmap to 2025 and a multi-day stakeholder event, driving insight and forward thinking across the industry;
- Launched Dynamic Containment in 2020/21 which is the first of our new end-state services to deliver faster-acting frequency response services to support our operations as the electricity system is decarbonised;
- Provided thought leadership on significant charging reforms and technical understanding of the transmission system and charging methodologies to provide qualitative and quantitative policy inputs, which will improve policy that impacts all stakeholders;
- Improved our code administration activities, resulting in a step change in average external satisfaction;
- Introduced day-ahead procurement ahead of schedule to enable greater market efficiency;
- We're co-creating new products for reserve reform, which we've accelerated in response to industry feedback.

Market Development and Transactions Performance:

To view our Markets success against performance metrics and key indicators please see Role 2 content in the ESO End of Year Performance Report [here](#).

Role 3 On A Page: System Insight, Planning and Network Development



What we do

The flow of electricity in Great Britain is getting more complex, but at ESO we are continuously developing plans for our future networks to ensure we can meet Great Britain's electricity system requirements. We're also preparing to operate at zero-carbon by 2025 as part of the UK's net zero target for 2050. Our System Insight, Planning and Network Development involves looking for solutions to challenges faced by both the ESO and other industry stakeholders in the electricity system. Ultimately, we want to find innovative new ways to operate the electricity system of today and tomorrow, and keep costs down for consumers. Some projects that look for these solutions include Voltage, Stability and Constraint Pathfinders as well as Regional Development Programmes.



What have System Insight, Planning and Network Development delivered for consumers?

- Optimised the Pennines pathfinder tender requirements, estimated to be approximately £60m cheaper than the original based on data from previous Voltage pathfinders. This could deliver consumer benefit of £14m;
- Our Northern England and Scotland Operability Study (NESOS) led to a recommendation that has the potential to save consumers up to £32m per year;
- Built the Future Energy Scenarios with our Bridging the Gap and Costing work, identifying only a 7% cost difference across scenarios and signposting actions to help Great Britain reach our net zero target.

System Insight, Planning and Network Development Plan Delivery: in 2020/21

- Efficiently processed twice the volume of connection offers than seen in previous years, unlocking the green energy transition for consumers;
- Engaged with over 220 stakeholders, from over 100 organisations, to produce our Bridging the Gap report on Future Energy Scenarios. This gives a closer look into what needs to be done to reach the UK's net zero 2050 target and includes recommendations for policy makers and industry participants;
- Joined the Energy Networks Association to collaborate with network owners and operators to accelerate progress towards a zero carbon electricity grid and the UK's net zero goal;
- Progressed the Regional Development Programmes, which look at the whole electricity system and assess a variety of options to resolve specific network needs. These significantly enhance transmission and distribution systems coordination and control and create efficiencies for the whole electricity system;
- Progressed the Loss of Mains Change programme, with 61% of at risk generation capacity achieving compliance or progressing to compliance. This means system changes are being implemented to create a more resilient grid that is protected from asset 'tripping'. This action is an important step on the road to net zero, as the more resilient our UK power grid networks are, the more renewable energy we can bring online;
- Network Options Assessment (NOA) opened to interested persons, one year ahead of the requirement to do so;
- Several pathfinder milestones including expressions of interest for Constraint Management;
- We engaged extensively on Early Competition, working closely with the ESO Networks Stakeholder Group;
- New interactive Electricity Ten Year Statement (ETYS) publication in response to stakeholder feedback.

System Insight, Planning and Networks Development Performance:

To view our Networks development success against performance metrics and key indicators please see Role 3 content in the ESO End of Year Performance Report [here](#).



The Covid-19 Pandemic

Impact:

Over the last year, we've faced a new challenge - operating through the Covid-19 pandemic. This has been a huge test of our business and the industry. As the full extent of the pandemic and its impact became clear, we took a number of measures to protect our control room colleagues in critical roles, introducing new layouts, enforcing social distancing, adding new hygiene measures and new shift patterns with teams permanently split across different sites. Our non-operational colleagues have adapted to working remotely and these steps have further increased the resilience of our operations, meaning that throughout the pandemic we have been able to protect our colleagues and fulfil our critical role. From day one we invested in new technology and rolled out software and hardware improvements to enable these new ways of working.

Societal changes due to Covid-19, coinciding with 2020 having the sunniest spring on record in the UK, led to significant impacts on electricity in Great Britain. At times, demand fell to 20% below expected levels and zero carbon sources made up their largest ever share of the power mix, meaning keeping the power system stable required more interventions than ever before. We recognised that this was increasing the cost of balancing the system, impacting our customers at a time of national uncertainty. We worked hard to provide balancing cost forecasts and transparency of our actions through regular dialogue with our customers to help them manage these new challenges.

Resilience:

This has provided a glimpse into what operating the future zero carbon electricity system could look like and the operational challenges that need to be addressed. High levels of generation and low demand can raise the risk of oversupply and reduce the system's resilience to sudden changes in frequency.

To overcome these challenges, we developed a series of new electricity market services to help balance the system. In May 2020, we launched Operational Downward Flexibility Management (ODFM) – a temporary marketplace to manage reduced demand – and in September, Dynamic Containment went live – a new fast frequency response service.

In collaboration with industry, we also made progress on our Pathfinder projects, identifying how we can replace the voltage, stability and constraint management services provided by fossil fuel generation with new, greener approaches. We're seeing synchronous condenser technology providing stability, batteries providing reactive power and we have also widened access to the Balancing Mechanism, making it easier for smaller providers to play a part.

2020/21 was a difficult year in many respects. This led to a reaction from the ESO both to protect those carrying out critical roles, and to address the new network management challenges. These actions provided essential stability and continuity of service during a complex year.

Key Events

Review of System Operation

When the ESO became a legally-separate company within the National Grid Group, Ofgem committed to reviewing the arrangements within two years. In January 2021, Ofgem published the outcome of this review.

Ofgem recommended that the ESO be given more roles and responsibilities, to help drive the UK towards its net-zero ambition. These include a greater role in onshore and offshore network planning, running competitions for onshore network assets, and management of data and digitalisation, among others.

They also highlighted that further roles and responsibilities may require additional separation of the ESO from National Grid. To this end, Ofgem recommended the creation of an Independent System Operator (ISO), outside of the National Grid Group.

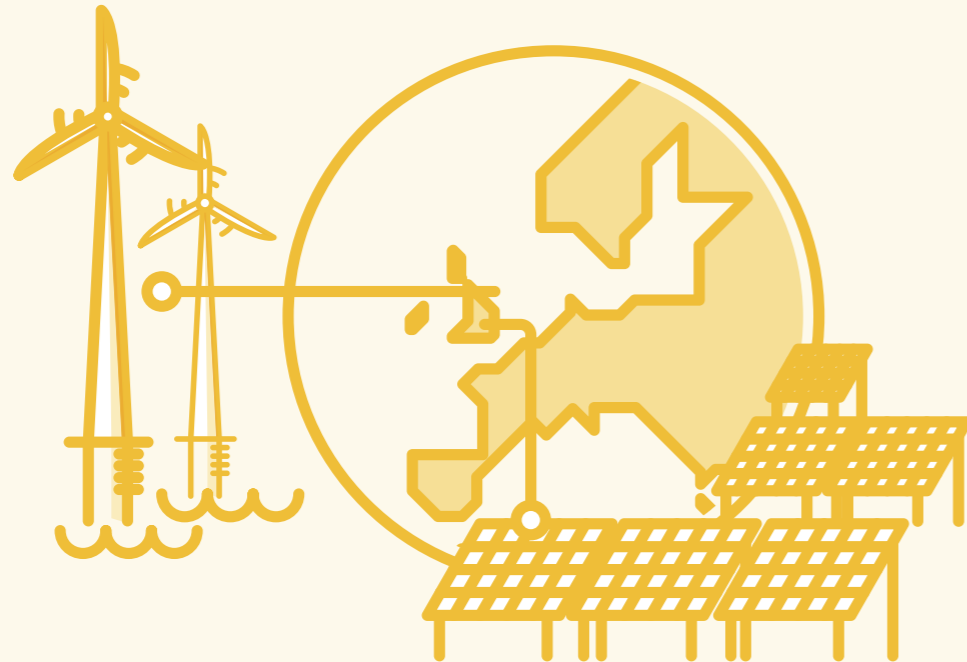
While Ofgem have recommended the creation of an ISO, the decision is for BEIS to take, and we expect that they will consult on this in the summer. We continue to engage with BEIS, and the energy industry, to develop proposals that are right for the challenges we face in getting to net zero.



Setting up for RII0-2

In December 2020, Ofgem detailed its final determinations for RII0-2 ahead of the new price control starting in April 2021. We are pleased that Ofgem recognised our RII0-2 business plan as ambitious and has agreed to fund us for the activities we want to deliver, approving £504m (98%) in 2018/19 prices of the costs we set out in our business plan for the first 2 years of RII0-2. The balance will be assessed at a later point, when there is more certainty around project costs.

In many of our priority areas, Ofgem has listened to our feedback and our stakeholders' feedback and made changes to the regulatory framework that will set us up to transform our role, deliver our ambitious plans and facilitate the transition to a zero-carbon electricity system. Over the five-year RII0-2 period, the activities set out in our business plan will generate net benefits of around £2 billion for consumers, lowering average annual consumer bills by around £3.



ESO led projects

We are undertaking some major transformational projects. These will deliver significant positive impacts for consumers by promoting competition, holistic thinking, and putting consumer interest at the heart of what we do. Three examples are set out below.

Early Competition:

Early competition refers to competition that occurs prior to the detailed design, surveying and consenting phases of solution development. This means organisations could compete for the design, build and ownership of onshore transmission solutions. Early competition will help encourage new ways of working and aims to seek the best solutions at a fair cost for consumers.

In May 2019 we were asked by Ofgem to develop an Early Competition Plan. This was to set out a possible model for early competition, including roles and responsibilities of parties in facilitating it. This project is a strong example of the ESO becoming a trusted partner and it aligns with our ambition of competition everywhere.

Following publication of our Phase 1 update in February 2020, we have developed the high-level models taken forward into a full end-to-end process. We have developed our proposals with stakeholders through a series of workshops, bilateral conversations and industry

consultations, ahead of submission to Ofgem at the end of April 2021.

The model we proposed sees a tender being launched once a reference option is available but ahead of surveys, detailed design and consenting. Competitions would be open to parties either building assets or delivering services to meet specified transmission system needs.

Following the submission of our final Early Competition Plan in April 2021, Ofgem have indicated they will run a consultation in the summer of 2021 with a decision on whether or not to implement Early Competition expected in autumn. Ahead of this, as agreed with Ofgem, we will be continuing with some key activities, focusing on internal processes relating to network planning and project identification.

Offshore Coordination:

We established the Offshore Coordination Project to explore the costs and benefits of a coordinated offshore electricity network. This project is a critical part of the BEIS-led Offshore Transmission Network Review (OTNR). It is an illustration of the ESO's trusted partner ambition and to the government target of reaching net zero by 2050.

Activity on the first phase of the project ran from April to December 2020. Work progressed at pace to assess the costs and benefits of a coordinated offshore network compared to the current approach, the technical requirements and how the offshore connections regime could change to drive greater coordination.

Analysis indicated that a co-ordinated approach could potentially save consumers up to £6 billion between now and 2050, and reduce the impact on the environment and coastal communities through a 50% reduction in the number of connection points.

The second phase commenced in January 2021, and we are working closely with BEIS, Ofgem and other OTNR partners and wider stakeholders to realise the economic, social and environmental benefits of a coordinated offshore network.

Markets Roadmap:

We have a unique role in the development of market arrangements, from reforms across balancing markets to running the Delivery Body within Electricity Market Reform. In March 2021 we set out a Markets Roadmap to 2025. This gives an overview of the transformational plans for markets through to 2025 across important system services such as frequency response, reserve and stability. Our Roadmap provides transparency on the case for change alongside our plans for how and when we will deliver reforms.

Our Roadmap is an important set of actions as we take the ambitious journey towards a net zero future. In the short term the Roadmap will deliver on our ambition to operate the system with zero carbon whilst also enabling competition everywhere. It outlines reforms to the structure and accessibility of markets, and will be an important enabler as a new energy landscape emerges, with different types of electricity generation, more participants in the electricity market and changing consumer behaviour.

Our plans align with other market reforms planned across the industry. We are designing and developing competitive markets collaboratively so that an ever-growing number of providers can access them. We are building on our existing market principles to design markets that are competitive and accessible, transparent, fair and coherent.

We are also turning our focus to long-term market reform. We have received strong stakeholder feedback that if Great Britain is to achieve its carbon targets, the current set of electricity markets and instruments for trading and balancing electricity, securing the system, and signalling investment, will not efficiently get us where we need to be. That is why, in Q4 2020/21, we launched a strategic project to assess the effectiveness of current market arrangements for achieving net zero; to identify and evaluate the range of potential solutions, and to recommend a package of Net Zero Market Reforms that achieves the best whole system outcome and best value for consumers. This project will run over the course of 2021/22, and will be undertaken in close collaboration with BEIS, Ofgem and industry stakeholders.

Progress against objectives – KPIs

ESO has a range of metrics against which overall performance is measured. The metrics in this section are aligned to our strategy and are reported to the Board.

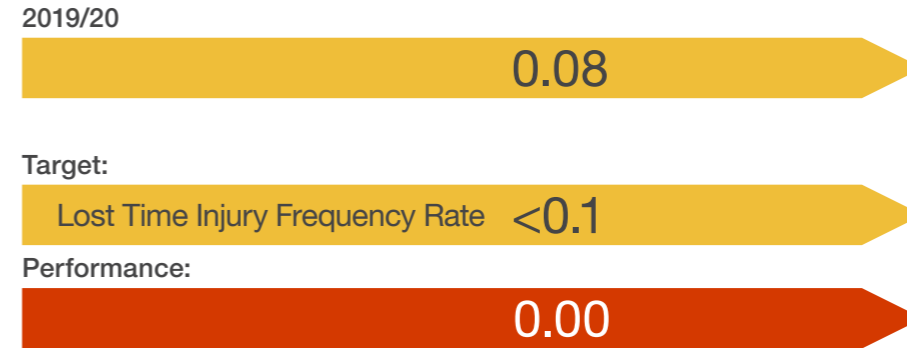


Safety

The safety of our employees is paramount. Each year we undertake a safety survey with our employees to gauge attitudes to safety, how effective our safety culture is and where employees believe we can improve. We also measure safety using the Lost Time Injury Frequency Rate metric. This industry standard approach measures the number of lost time injuries occurring for every 100,000 hours worked.

Progress in 2020/21

This year’s result was strong, with no injuries causing lost time during 2020/21. The ESO in conjunction with the Safety, Health and Sustainability team (SHS) and our local Safety, Health and Wellbeing champions continue to improve our targeted plans to address any areas of concern and build on the work done to date.





Balancing costs

Electricity can't be efficiently stored in large quantities in a cost-effective way, part of the ESO's role is to find ways to match supply with demand. We call it "balancing", and we do it minute by minute. To help us with balancing, we buy in services from suppliers. These are "Balancing Services" and we use them to keep the transmission system running reliably and economically.

The target is based on a rolling average over five years (with adjustments for significant cost drivers).

Progress in 2020/21

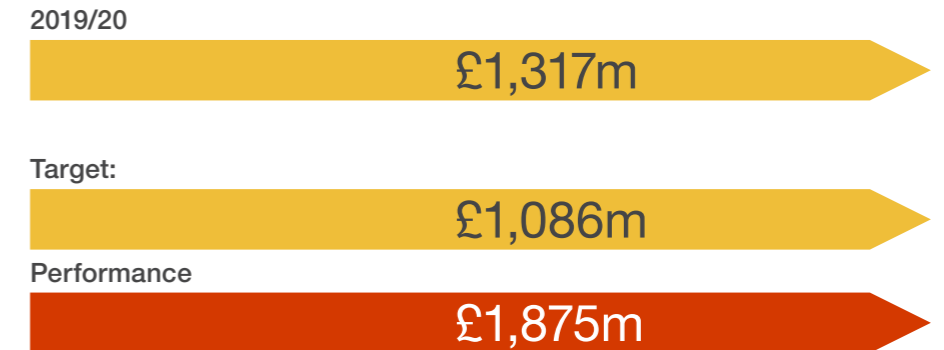
Balancing costs in 2020/21 were higher than expected owing to a number of factors – including the Covid-19 pandemic and weather patterns – which created a challenging operational environment. Frequency control and the management of voltage, stability and thermal constraints were operational challenges and the main areas driving balancing costs.

Several factors influenced the higher cost of balancing the system in 2020/21. The effects of the Covid-19 pandemic and lockdown on the electricity system were seen throughout the year,

affecting demand in spring, summer and autumn. It did lead to considerable demand uncertainty due to Great Britain leaving and re-entering lockdowns. This uncertainty meant we took more action in securing the system, which increased costs. Although balancing services proved more costly than anticipated in 2020/21 due to demand side challenges, we do foresee these costs rising over the coming decade due to the difficulty of balancing the grid with a heavier renewables mix on the supply side.

While higher balancing costs are also a feature of a system with higher volumes of renewable generation, our work to transform the system, so that it can be safely operated using only zero-carbon generation, will give us the tools to utilise more renewables rather than pay constraint costs.

More broadly, the growth of renewable generation and consequent changes to the generation mix have also increased the quantity and volume of balancing services we've needed to use – since the higher volume of renewable generation on the system is less predictable and controllable than conventional generation.





Financial Performance

The **financial results** set out on **pages 34 - 39** reflect the second year of legally separate operation following our establishment as a legally separate company within the National Grid Group on 1 April 2019.

Progress in 2020/21

Financial performance was in line with expectations for a strong year of trading. Revenues increased in the year by £476m compared to FY20 largely due to increased BSUoS charges. Controllable costs were maintained in line with efficiency targets set out for the year. Operating Profit was lower than FY20 due to the one-off items last year such as income for legal separation and reopeners including Cyber and Data Centres, for which costs were largely incurred in other years. Further information is set out within the financial review later in this report.



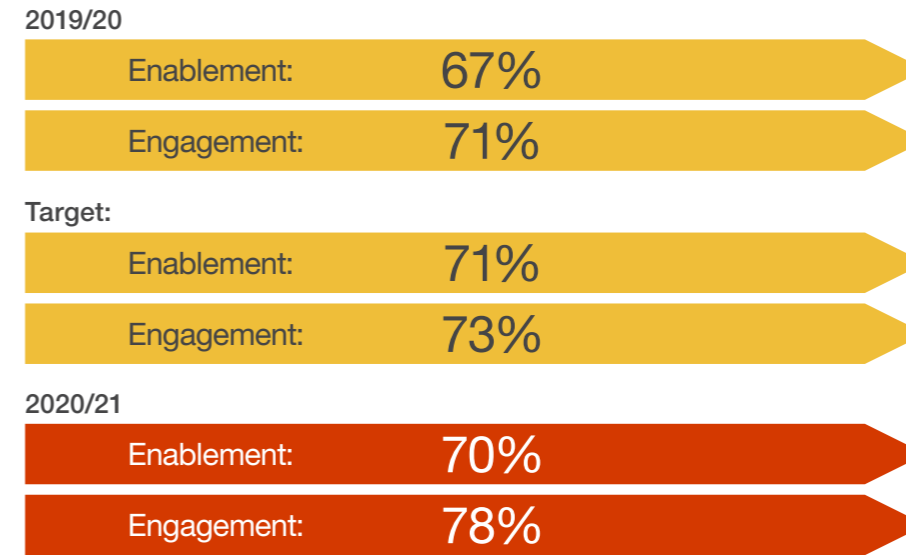


Employee Engagement and Enablement

Our employees are our biggest asset and the best advocates for our business and what we aim to achieve. They are at the heart of everything we do, so it is vital for us to be aware of their thinking on a wide range of issues about our business: what it's like to work for us; things we do well; things we could do better and much more.

Progress in 2020/21

Our employee engagement and enablement scores demonstrate a substantial improvement on 2019/20.



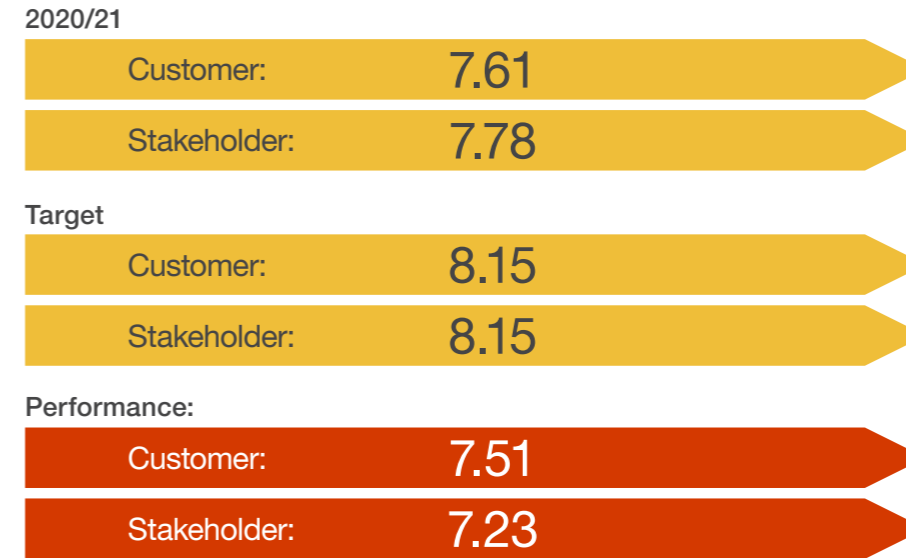


Customer Satisfaction

It is vital we understand what customers think about our business and how well we are carrying out our operations to serve their needs. That is why we regularly survey our customers to ask how satisfied they are with our service.

Progress in 2020/21

Both the customer and stakeholder satisfaction scores are based on responses from more than 200 surveys. The results are below our target for the year and highlighted a need for greater transparency and co-creation with our customers and stakeholders. It is critically important to us that we listen and respond to this feedback. Our customer strategy in 2021/22 is focussed on delivering faster insights to action and becoming a trusted partner. This will be achieved through a range of activities such as new customer journey mapping to address pain points, consistent engagement plans and impact assessment tools to ensure earlier engagement, collaboration and transparency of our decision making.





The Directors present their Strategic Report on the Company for the year ended 31 March 2021. This includes an overview of the ESO's structure, 2020/21 performance and strategic outlook, including risks and uncertainties.

Our people

Our most important resources are undoubtedly our people. This year, more than ever, we have put our people and their wellbeing at the centre of our agenda, supporting everyone as best we could through the pandemic and these challenging times.

Inclusion and diversity

Our inclusion and diversity policies demonstrate our commitment to providing an inclusive, equal and fair working environment by:

ESO	Gender Split	Ethnic diversity
Workforce	65/35	30%
Executive team	50/50	20%
Board:	50/50	-%

- Driving inclusion and promoting equal opportunities for all;
- Ensuring employees, part-time, full-time or temporary, are treated fairly and with respect; and
- Eliminating discrimination; and ensuring that employment, promotion, training, development, benefit and reward is merit-based, in line with relevant legislation.

We are taking action at all levels of the organisation to ensure that we create an inclusive environment where everyone can reach their full potential:

- The ESO supports the Employee Resource Groups who drive initiatives to increase inclusion and diversity in our Company;
- Diversity and inclusivity are integrated into the Board agenda. The Board regularly engage with employees creating and supporting an inclusive workforce;
- The ESO has committed to only participating in public engagements and speaking opportunities where there is an appropriate gender balance; and
- This year, the ESO set up a "Belonging Forum" to promote, champion and encourage diversity, inclusion and 'belonging' in the ESO.

Employee engagement

We engage and consult regularly with employees to make sure they are up-to-date on the Company's performance, plans and priorities and give them the opportunity to raise questions or concerns.

We also conduct an annual employee engagement survey, providing an opportunity for all our employees to share their views on the employee experience at the ESO and providing the Board with a barometer of the workforce's confidence in the strategic direction, optimism for the future, overall engagement and pride in the organisation.

Due to the unique working conditions imposed by the Covid-19 pandemic, engagement with our staff has never been more important. Together with the Executive Team, the Board have overseen initiatives to remove frustrations, improve employee relations and make working life better for our workforce. Examples include

improving IT applications, encouraging more flexible working practices, developing wellbeing initiatives and communication channels such as the regular all-ESO calls, leadership calls and visibility sessions. We have also focussed on wellbeing – introducing an index to measure this in the employee engagement surveys. 2020/2021 saw increases in the ESO's engagement (from 71% to 78%) and enablement scores (from 67% to 70.4%) demonstrating the positive impact these changes have had.

Training

We have a continuing commitment to training and personal development for our employees. Our priorities include compliance, technical and leadership training, in alignment with the key skills builds that we want to make in preparation for the delivery of our RIIO-2 ambitions. In addition, our engineers in the control room undertake frequent training as a core part of

their highly specialised roles. A significant achievement during 2020/21 in the Control Centre was that 30 employees were trained and authorised to carry out full Power Systems Engineering roles for our electricity network.

Rewards and benefits

By developing our people and providing a wider programme of benefits, we aim to have an engaged and productive workforce. To attract and retain employees, we make sure our remuneration package is both fair and competitive.

We do this in line with National Grid processes through a regular review of our salaries and benefits against appropriate peer groups to make sure we remain competitive in the relevant market. The primary focus for reward comparisons is UK general industry and energy services companies; these peer groups are considered appropriate for a large, complex and predominantly regulated business.

To ensure fairness from both external and internal perspectives, we review salaries annually and broadly target mid-market total remuneration levels of our peer group. In addition to market data, we also take into account factors such as business performance and individual contribution, the individual's skills and experience, scope of the role and include any changes in responsibility.

Furthermore, while pay increases are generally aligned to salary increases received by the wider workforce (other Company employees) and to market movement, increases in excess of this may be made at the Remuneration Committee's discretion. This may include circumstances such as a significant change in responsibility, progression if more recently appointed in the role, and broad alignment to mid-market values.

Health and safety

The safety of our employees is of paramount importance. This includes the mental and physical health and wellbeing of our employees as they travel, work from home, work shifts and operate in a rapidly changing and challenging industry. The ESO has been carefully tracking the direct and indirect impact of the Covid-19 pandemic on its employees as well as introducing measures and providing guidance on a wide range of issues to help protect and support them. This includes protective measures for those critical or vulnerable workers that can't work from home, redeploying teams to other areas of the business to support prioritised work, helping those with caring responsibilities and allowing time off work to support volunteering efforts.

Each year we undertake a safety survey with our employees to gauge attitudes to safety, and highlight gaps where employees believe we can improve. The Board reviews the annual survey results and maintains oversight of the resulting actions. We are working to make sure that safety is not seen as a 'priority' but as 'the way we do things'.

This year, the safety survey was complemented with a survey about mental health at work, "Workplace Wellbeing Index", a survey that was particularly relevant in the context of the Covid-19 pandemic. Results showed our people asking us to focus on mental health and working from home when we consider workplace safety, consequently we are focusing efforts on this during 2021/22.

Employee regulation

Our values, outlined on [page 6](#), help to guide our strategy, decisions, processes and culture. The values are defined in the 'Code of ethical business conduct' and outline the behaviour we expect of all our employees, from the Board down.

The Board has adopted the National Grid standards and policies for governance, human resources, finance, digital risk and security, safety, health and environment, procurement, anti-slavery and human trafficking, and anti-fraud and bribery. All employees undertake training to embed the principles into our culture and values.

Senior management submit an annual declaration confirming the steps they have

taken during the year to promote a positive ethical culture in line with the requirements of the Ethics Business Management System and that all employees are aware of the 'Code of Ethical Business Conduct' and complete its e-learning module.

If any employee wishes to highlight any potential breaches to the Code of Conduct, they can contact the independent whistleblowing services provider and a formal investigation follows, with anonymous reporting to the National Grid Audit Committee.

Our business environment

ESO operates in a changing environment, one that is driven by concerns over climate change and the need to achieve net zero by 2050. That is why our business plans are designed to enable the transition to a flexible, low carbon energy system. Our operating environment is regulated, with our business plans developed in collaboration with stakeholders and reviewed by Ofgem.

	21/22 Q1 & Q2	21/22 Q3 & Q4	22/23 Q1 & Q2	22/23 Q3 & Q4	23/24	24/25	25/26	
Role 1: Control Centre Operations	Deliver new control centre capability	Define future system architecture and design	Develop foundational architecture	Deliver first new balancing application components	Deliver new core situational awareness tool	Enhanced balancing capability delivered Ability to schedule and dispatch all parties 1 MW and above	Deliver fully capability of new situational awareness tool	Further iterations based on priority needs
	Enhanced control centre training and simulation	Engage with academia on new courses		Run new university modules in system operation		Training integrated with new balancing capability	Training integrated with new situational awareness capability	Fully integrated training and simulation capability
	Improve transparency of decision making	Start data platform foundation work	Data platform requirements and design work	Deliver data platform foundation	Integrate data platform with digital engagement platform and single markets platform	Integrate data platform with enhanced balancing tool	Integrate data platform with new situational awareness tool	Continued data platform expansion
	Restoration for a zero-carbon system	Establish proof of concept for Distributed Restart		Commence build of restoration decision support tool		ESO facilitating annual assurance process against new restoration standard	Deliver restoration decision support tool	Distributed resources able to fully provide restoration services
Role 2: Market development and transactions	Product roadmaps for response and reserve implementation	Trial day-ahead frequency response market	Design and implement reformed reserve products	Reserve products integrated with foundational single markets platform	Single day-ahead response and reserve market Single integrated platform for ESO markets	Start balancing and wholesale market review		
	Stability market development	Day-ahead response market integrated with foundational single markets platform	Define scope of stability market		As required, initiate plan to deliver stability market			
	Product roadmap for reactive implementation	Establish and kick off reactive power market design work to explore the solution for reactive reform	Complete reactive power market design and feasibility study to recommend and agree the scope and plan for delivering reactive reform	Dependent on the result and decision of reactive market design, initiate the delivery of reactive reform as required				
	Improving the way we facilitate code change	Stakeholder engagement and consultation on the process to amend our codes	Create and consult with stakeholders on plan to deliver the transformed codes process	Licence changes to support transforming the process to amend our codes	Transform the process to amend our codes - go-live	Implement change to codes required to create whole system Grid Code		Digitalised whole system Grid Code

Our business environment continued

Our business plans

We are regulated by Ofgem, and in December 2020 Ofgem delivered their final determination on our next price control period (known as RIIO-2). The table below provides a high-level summary of our RIIO-2 business plans, and you can read the full detail [here](#).

	21/22 Q1 & Q2	21/22 Q3 & Q4	22/23 Q1 & Q2	22/23 Q3 & Q4	23/24	24/25	25/26
Deliver a customer connections hub		(Q4) Minimum Viable Product delivery of platform	(Q1) Further development and testing of the hub with customers		(Q4) Implementation of phase 1 of the connections hub		Phase 2 of the connections hub completed
Regional Development Programmes		(Q4) WPD & SSE-N 'N-3' Intertrip RDP complete			(Q3) Generation Export Management Scheme (GEMS) RDP go-live (Q4) Publication of roadmap for national roll-out; South West (WPD) MW dispatch RDP complete	South East (UKPN) MW dispatch RDP complete; Midlands Storage (WPD) MW dispatch RDP complete	Further RDP (to be determined) complete
Enhance the NOA and assessment capability	Connection wider works trials, in selected geographic regions, in NOA. Implement new probabilistic and economic analysis tools		NOA 2024 makes recommendations on future end of life asset replacement			Implement stability assessment tool	
Pathfinders	Improve tender processes and identify new areas of system need	Conclusion of stability pathfinder phase 2 Award contract for Pennine pathfinder	Constraint management pathfinder phase 1 progressed. Support framework change to reduce barriers to entry			Implement improved tender approaches that enable more participants to enter the market	
Supporting Distribution Future Energy Scenarios	Engage with DNOs on their ED-2 plans and with the Open Networks project		Share FES building block data. Develop and share data reports and insights (with DNOs) to develop regional assumptions. Implement new energy demand model				



An electricity system that can operate carbon free



A whole system strategy that supports net-zero by 2050



Competition everywhere



The ESO is a trusted partner

Our commitment to being a responsible business

In today's world, business needs to be a positive force for good. This belief is central to the way we work and why we do what we do. Businesses are a key part of their communities and we believe they should leave a positive legacy for future generations. At the ESO, we work hard to exceed the expectations of our customers, shareholders and communities. We are passionate about operating our business in an environmentally responsible way. It is the right thing to do – for society and for us. Sustainability shapes our thinking and decision-making. It means we run our business as efficiently as we can, provide value for our customers, and protect the environment. For us, being a responsible business means being a good citizen and driving social change, which covers every aspect of our work. What we do helps to underpin the prosperity and wellbeing of communities.

In October 2020 we adopted the National Grid Group Responsible Business Charter to bring a focus on responsibility into our actions. It sets our five areas of focus:



1. The environment

We will enable a fair and affordable transition to a clean energy economy and reduce our own emissions.

Our biggest impact in this area is our ambition to be able to operate carbon free by 2025. This year we saw ground breaking projects come forward to move us along this path. These include Dynamic Containment, the first in a suite of new fast-acting frequency products, which is boosting the network's ability to respond rapidly to disturbances in the flow of energy around the grid, and the Accelerated Loss of Mains Change programme, where we are working with regional networks to help the generators connected to them reduce their risk of unnecessary tripping.

In 2018 we developed an internal Environmental Sustainability Business Management Standard (BMS) that brings together the commitments from our Contribution and our Environmental Policy. This gives clarity to all our employees and also puts sustainability at the heart of our environmental management systems.

We are working with the global electricity community on the path to net zero.

This year we set up the Global Power System Transformation consortium (G-PST) to work with other system operators on decarbonising power grids.

Coupled with that, we have set up the Engineering Advisory Council, with membership from academia and Europeans Transmission System Operators with the aim to direct research into the engineering challenge of zero carbon grid operation.

Reducing greenhouse gas emissions is important for us. You can find details of National Grid plc carbon emissions, and greenhouse gas reduction targets, in the Group's annual report and accounts. We have committed to implementing the Task Force on Climate-related Financial Disclosures recommendations, demonstrating how climate change risk and opportunities are central to our thinking, with clear targets to measure progress.

2. Our communities

We will deliver sustainable energy safely, reliably and affordably ensuring no one gets left behind. The ESO is part of the fabric of the communities we serve – we keep the lights on, we keep homes powered, we help economies to thrive. We are an operator, an employer, and use local suppliers. We support our communities with the time and expertise of our people, and through corporate giving programmes.

Last year we introduced a community fund to help local communities during the pandemic. We donated £85,000 in April 2020 to fund projects close to our employees' communities, predominantly in Warwick and Wokingham sites such as a food bank, a befriending service, community kitchens and other care services. In April 2021 we ran a second funding round and allocated a further £100,000 to support local projects.

3. Our people

We will develop the right skills to enable and accelerate the energy transition and strive to build a diverse work force and inclusive culture. To make sure we have the right skills to meet the challenges of the future and deliver on our ambitious RII0-2 business plan, we will be recruiting c.200 roles across Warwick and Wokingham in the next year. You can read more about our commitment to our people on [page 23](#).

4. The economy

Our economic contribution to society comes primarily through delivering secure and reliable electricity. We power businesses and homes, and partner with regulators, our business partners, suppliers and other key stakeholders. We make sure energy reaches homes and businesses safely, reliably and efficiently. But our contribution as a responsible, purpose-led business also comes as an employer, a tax

contributor, a business partner, a community partner and a member of the B Team movement. Commitments include:

- Maintain reinvestment in our infrastructure and show the consumer benefits of our delivery plans;
- Continue to invest in developing technologies and innovations that benefit the industry and society;
- Work across our supply chains to ensure that, together, we reflect the diversity of the communities we serve;
- Continue to influence our supply chain to operate as responsible businesses;
- Meet or exceed the B Team Responsible Tax Principles.

5. Our governance

We will make sure our governance mechanisms reflect our commitments, and that the principles of responsibility guide us in everything we do.

Human rights

Respect for human rights is incorporated into our employment practices and our values, which are integral to our Code of Ethical Business Conduct.

Our Global Supplier Code of Conduct (GSCoC) makes sure our suppliers comply with all legislation relating to their business, as well as the principles of the United Nations Global Compact, the International Labour Organisation Minimum Standards, the Ethical Trading Initiative Base Code, the UK Modern Slavery Act 2015 and for UK suppliers, the requirements of the Living Wage Foundation.

Preventing modern slavery

We expect our suppliers to be compliant with the Modern Slavery Act and to publish a Modern Slavery Statement if required. Each Year National Grid updates the Group's Modern Slavery and publishes this outline [here](#). The Statement is independently reviewed by the Business and Human Rights Resource Centre.

National Grid is a member of the United Nations Global Compact Working Group, focusing on Modern Slavery, and is working with Achilles to develop a community approach to the issue and review our procurement process, so that modern slavery criteria and identifying risks, forms part of our sourcing process.

Anti-bribery and corruption

In National Grid there is a company-wide framework of controls to prevent and detect bribery. We thoroughly investigate all allegations of ethical misconduct and, where appropriate, take corrective action and share learnings. We record trends and metrics – only a small percentage of these relate to bribery or corrupt practices, so we do not consider them to be material for reporting purposes.

Governance and oversight

We regularly review our framework to be sure procedures remain proportionate to the principal risks. Our Ethics and Compliance Committee (ECC) oversees the Code of Ethical Business Conduct and awareness programmes. Cases alleging bribery are referred to the ECC so its members can make sure cases are investigated promptly and acted on. Lessons learnt are communicated across the business.

Anti-bribery policy

The National Grid Group Policy Statement – Anti Fraud and Bribery – sets out our zero-tolerance approach. It applies to all permanent employees, temporary agency staff and contractors. To make sure of compliance with the UK Bribery Act 2010, we conduct annual fraud and bribery risk assessments. We have an e-learning course for all employees setting out our zero-tolerance approach.

Whistleblowing

Confidential external whistleblowing helplines are available 24/7 to all employees so concerns can be reported anonymously. These are publicised internally and on the external website. Our policies make it clear that we will support and protect 'whistle-blowers' and any retaliation will not be tolerated.

This process is a shared service within National Grid Group and there is also an independent mechanism for reporting System Operator Financial Information concerns, for issues arising due to legal separation.

Ethical business conduct

Our Code of Ethical Business Conduct sets out the standards and behaviours we expect from all employees. It is issued to all employees and is supported by a communication and training programme to promote a strong ethical culture.

Suppliers

Our Supplier Code of Conduct sets out our requirements that have procedures in place to prevent and detect bribery and corruption, in accordance with all applicable local, state, federal or national laws or regulations, including the UK Bribery Act 2010. We provide guidance and briefings for high-risk areas, so contractors, agents and others acting on behalf of ESO do not engage in any illegal or improper conduct. The National Grid Global Procurement team carries out regular supplier screening to identify any requirements for prosecutions or sanctions within our supplier base.

Compliance framework

Each business area is required to consider its specific risks and maintain a compliance framework, setting out its controls to detect and prevent bribery. As part of our compliance procedure, each business is asked to self-assess its controls and provide evidence that supports its compliance.



Internal control and risk management

The Board is committed to protecting and enhancing the ESO's reputation and assets, while safeguarding the interests of our stakeholders. The ESO is exposed to threats, opportunities and uncertainties that could impact its financial situation, its operational results, and its reputation. The ESO's risk management framework is in place to identify, assess, manage, monitor and escalate risks and ensure internal controls are implemented to provide mitigation. The Board sets and monitors the amount of risk the ESO is prepared to seek or accept in pursuing its strategic objectives through the implementation of its risk appetite.

The Audit and Risk Committee is responsible for overseeing the ESO's risk management process and the Board is responsible for the appropriate identification of our principal risks and the effective implementation of mitigating activities for other key business risks. Internal Assurance and Corporate Audit provide independent assurance to management and the Audit and Risk Committee as to the effectiveness of controls put in place to mitigate risks.

Risk management process

The ESO accepts that it is not possible to identify, anticipate or eliminate every risk and that taking appropriate risks is an inherent part of doing business. However, the risk management process provides assurance that we understand, monitor and manage the key risks and uncertainties we face in delivering our objectives.

The ESO has an approved Risk Management Framework in place which is supported by risk champions who aid the business in its application. The ESO identifies appropriate risk owners to be accountable for controlling and mitigating their respective risks.

Our risk profile contains the risks that cover the enterprise activities of our business, of which the Board have identified seven Principal risks

as we endeavour to achieve our strategic and customer objectives. These Principal risks are agreed through discussions with the Executive Team and the Board. The risks are reported and debated with the Executive Team and the Board on a regular basis. We test our principal risks and wider departmental risk registers at least annually to establish their impact on the ESO's ability to continue operating and to meet its deliverables.

The ESO is in the process of establishing a dedicated ESO Emerging Risk Register and expect this to be completed and utilised during 2021/22. The ESO currently feeds into the wider National Grid Group process with more details available via the National Grid Annual Report.

Risk appetite

The Board have implemented a risk appetite framework linked back to our risk framework. This was introduced in May 2020 and identifies an 'Averse', 'Neutral' or 'Tolerant' position for each risk appetite theme and has been embedded in the risk management process and reporting. The framework is reviewed annually by the Board and tested to ensure it is fit for purpose. The Board's appetite provides additional sources of management information to assess risks.

Top down, bottom-up assessment

The ESO has a 'top-down, bottom-up' approach where all key business areas identify key risks to our business model and our business objectives. Each risk is assessed by considering the financial, operational and reputational impacts, and how likely the risk is to materialise. The business area identifies and implements mitigation to manage and monitor the risks. The most significant risks are highlighted in our executive risk profile and reported to the Audit and Risk Committee and the Board. Additionally, the Audit and Risk Committee and the Board may also identify and assess other significant risks. These risks and any associated management actions are cascaded through the organisation as appropriate.

Changes during the year

The ESO's risk profile has been reviewed to account for the change driven by the Covid-19 pandemic. While it has not significantly changed our principal risks and scores, there have been impacts to the operation of the energy networks that have seen transient risks being managed further down the business. Each principal risk, detailed below, has been reviewed in this financial year and we continue to work on reporting Key Risk Indicators which will help enhance the monitoring and mitigation of risks.

The ESO held a Principal risk relating to the recent negotiations pertaining to our RIIO-2 price control submission. This risk has been replaced by a new risk that focuses on ensuring we deliver the outcomes we committed to in this our Business Plan.

Ofgem's final determination for the RIIO-2 price control, published in December 2020, will further mitigate the ESO's cash flow risk once fully implemented. Ofgem confirmed their policy intent to transfer the cash timing risk associated with collection of TNUoS revenues to the onshore Transmission Owners from April 2021. This decision has been appealed and we await the decision of the Competition and Markets Authority expected in October 2021. ESO has implemented the RIIO-2 recovery of bad debts intent, which now provides the ESO with certainty over recovery of such sums and further reduces the cash flow risk.

A new risk Power System Transition was added to the Principle risk register, focusing on our ambition to be able to operate the electricity network carbon free by 2025.

Our principal risks

Our Principal risks focused on key business risks during the year and are supported by the wider National Grid Principal risks to ensure full risk landscape coverage.

Principle Risk	Description	Mitigation
Political Uncertainty	Political events occur that cause politicians and policy makers to review roles and responsibilities of the ESO	<ul style="list-style-type: none"> • Policy Group and Policy teams in place • Regular 'tripartite' meetings at all levels • Proactive engagement and briefings held with Government, BEIS, Ofgem and other key stakeholder groups • Coordinated horizon scanning across ESO (regulatory and policy)
Power Systems Transition	Failure to adapt as the power system transitions to be more sustainable leads to high costs and/or system security issues	<ul style="list-style-type: none"> • Strategic programmes have been set up to focus on the following: <ul style="list-style-type: none"> - Whole System - Zero Carbon Operation - Competition Everywhere • Proactive engagement to shape policies and public debate to ensure stakeholders understand the role of the ESO in a decarbonized system
ESO Critical National Infrastructure (CNI) Systems	Ensuring our CNI systems remain available and resilient to malicious or other threats. Maintaining and transforming these systems to facilitate the needs of our customers now and in the future	<ul style="list-style-type: none"> • Established cyber security monitoring and testing in place • Active system health monitoring • Tactical upgrade programmes • Strategic system change programmes are in flight
ESO Cashflow	Our role in undertaking industry revenue management could negatively affect ESO cashflow in the short to medium term	<ul style="list-style-type: none"> • Governance and testing in place • Strong credit management process • Significant credit facilities • Bad debt management and new bad debt recovery terms within our RIIO-2 framework • SOx controls

Principle Risk	Description	Mitigation
Significant Energy Disruption	The ability for the ESO to predict and respond to significant disruption of electricity energy that adversely impacts our customers and/or the public	<ul style="list-style-type: none"> • Long and short-term energy forecasting and market information provision • Network design and analysis • Codes and obligation management • Emergency exercises and industry testing
Business Resilience	Inability to respond to an event outside the ESO's initial control (excludes CNI)	<ul style="list-style-type: none"> • Compliance with ISO22301 and Internal Business Management Standards for data management and business continuity management • Regular testing • IT support contracts and monitoring for key systems • Provision of equipment and systems to enable remote working • Covid-19 arrangements (as per government guidelines)
RIIO-2 Readiness	Ensuring we are ready to deliver the significant change programme associated with our RIIO-2 deal	<ul style="list-style-type: none"> • Skills and capability framework • Significant recruitment • Coordination with technology delivery planning with IT • Coordinated delivery planning ensuring management of both RIIO-2 and non-RIIO-2 dependencies

Risk evolution

The ESO continues its risk maturity journey having recently revised its risk management framework, risk landscape and risk portfolio. We now transition to the next phase focusing on embedding the changes and building up the maturity of risk and controls ownership within the business.

Financial review

The following financial results represent the second year of legally separate operation. The financial year 2019/20 was the first financial period for Electricity System Operator Limited (ESO) prior to which it was a dormant company consisting of a single £1 share. As such the 2019-20 period represents our first and sole set of comparative figures.

Revenue for the year 2020/21 was £2,127m (2020: £1,651m) with an operating profit of £41m and adjusted operating profit of £62m (2020: adjusted and operating profit £136m). Further details relating to the collection of revenues can be found in Note 2 of the financial statements.

Covid-19 presented unprecedented economic circumstances and while the full impact on the UK economy remains uncertain, we know UK gross domestic product declined by 9.9% in 2020. As components of the measure for production annually in the UK, electricity and gas fell by 4.5%, with falls of 10.0% in gas and 3.0% in electricity as demand declined during 2020. The ESO reacted quickly, adopting appropriate measures to protect our workforce, balance the electricity system and keep the lights on.

Covid-19 had a clear impact on the ESO in the 2020/21 financial results. We saw a reduction in electricity demand in 2020/21 given the national lockdowns and closure of businesses.

In our role as revenue collection agent for Transmission Network Use of System ('TNUoS') revenues on behalf of the Great Britain Transmission Owners, we were exposed to under-collection of revenue as consumer usage reduced. This impacted our cash flow by £109m for 2020/21 as we collect

revenue based on actual consumer usage whilst being billed based on fixed Transmission Owner forecasts. This is a timing difference which is explained in greater detail within Note 2 of the Financial Statements.

As a result of lower electricity demand, and record levels of renewable generation in the year, we saw increased balancing costs. This is reflected in increased Balancing Service Use of System ('BSUoS') costs in which are pass-through in nature.

We worked with industry and Ofgem on financial support packages relating to both TNUoS and BSUoS charges, to support the industry through these unforeseen challenges over the last 12 months.

For TNUoS, we worked with the Transmission Owners to provide targeted financial support to Suppliers in the industry over the summer and autumn period. This cost £10m and was funded by participating Transmission Owners but transacted through the ESO.

For BSUoS, we provided temporary support to Suppliers and Generators to defer the payment of an element of the summer excess BSUoS costs as a result of Covid-19. This cost £21m

and will be recovered in the coming financial year 2021/22. Bad debts remained low at £2.6m (TNUoS & BSUoS) during the year despite the economic shock brought about by the pandemic. This amount will be fully recovered through RIIO-2 revenues.

We did not see any material impact on our capital expenditure as a result of measures taken in response to the Covid-19 pandemic. Our funding position continues to be strong and we are carefully monitoring our liquidity and working capital. Our balance sheet at 31 March 2021 showed cash, cash equivalents and financial investments of £216m and we had undrawn external facilities amounting to £550m.

Our position and that of the market will continue to be monitored closely throughout the duration of the Covid-19 pandemic and the subsequent economic recovery.

RIIO Price Control

As we operate as a monopoly, our business is regulated by Ofgem. The regulator puts in place an incentive regime that ensures our interests are aligned with those of customers and society.

Ofgem's regulatory regime for the energy industry is titled RIIO, which stands for Revenue = Incentives + Innovation + Outputs. It is designed to encourage companies to invest in efficiency and innovation.

The RIIO-T1 price control ran for an eight year period and ended on 31 March 2021. Allowed revenue to fund an efficient level of expected costs ("totex") is split between RIIO "fast" and "slow" money categories using specified ratios that are fixed for the duration of the price control period. Fast money represents the amount of totex we are able to recover in the year of expenditure. Slow money is added to our Regulatory Asset Value ("RAV"). In each

year we are allowed to recover a portion of the RAV (regulatory depreciation) and a return on the outstanding RAV balance.

	2021 £m	2020 £m
Opening Regulated Asset Value (RAV) ¹	211	195
Asset additions (slow money) (actual)	58	62
Performance RAV or assets created	1	(3)
Inflation adjustment (actual RPI)	3	5
Depreciation	(51)	(48)
Closing RAV	222	211

¹April 2019 opening balances include amounts acquired as part of the ESO business

In the year, RAV grew by 5% driven by slow money expenditure (capital expenditure) and inflation adjustments in-line with RPI offset partly by regulatory depreciation.

RIIO-2

The RIIO-2 price controls started on 1 April 2021. We submitted our business plans, which were developed through extensive enhanced stakeholder engagement, to Ofgem in December 2019. Ofgem published its Final Determinations for the first bespoke price control for the legally independent ESO in December 2020. This was followed by the publication of the RIIO-2 licences in February 2021.

The price control is set to run for a five-year period. The price control and incentives design recognises that much greater value is drawn from the ESO's delivery of wider energy system outcomes, than from achieving efficiencies within its internal expenditure. The introduction of a pass-through funding approach, supported by incentives to deliver value for money, will enable the ESO to be agile and adapt quickly as the pathway to Net Zero evolves.

The RIIO-2 Final Determination reallocated the TNUoS cash flow risk to the onshore Transmission Owners. This aspect of the Final Determination is subject to an appeal to the Competition and Markets Authority ('CMA'), with a decision due in September 2021 and therefore may be subject to change.

Brexit

Brexit has not posed a key risk for the ESO. Mitigating action during the Brexit transition phase regarding our access to energy markets supported our ongoing activities, and negotiations around shared technology and platforms will continue to be monitored with the risks and uncertainties managed through our existing risk processes, particularly regarding access to exchange replacement reserves.

Use of adjusted profit measures

In considering the financial performance of our business, we analyse each of our primary financial measures of operating profit, profit before tax and profit for the year attributable to equity shareholders, into two components.

The first of these components is referred to as an adjusted profit measure, also known as ‘underlying’ or a ‘business-performance’ measure. This is used by management and forms part of the incentive target set annually for remunerating employees and Executive Directors. The adjusted profit measure excludes exceptional items and re-measurements. These are reported collectively as the second component of the financial measures in actual profit.

We believe that by presenting our financial performance in two components it is easier to read and interpret financial performance between periods, as adjusted profit measures are more comparable having removed the distorting effect of the excluded items. Those items are better understood when separately identified and analysed.

The presentation of these two components of financial performance is in addition to, and not a substitute for, the comparable total profit measures presented.

Management uses adjusted profit measures to monitor financial performance. These measures are also used by National Grid Group in communicating financial performance to its investors in external presentations and announcements of financial results.

Reconciliation of adjusted profit measures

Reconciliation of adjusted operating profit to operating profit.

There were no exceptional items or remeasurements included within operating profit for the year ended 31 March 2021.

	Years ended 31 March	
	2021 £m	2020 £m
Operating profit	41	136
Timing in respect of BSUoS	21	-
Adjusted operating profit	62	136

Under the regulatory arrangements the level of actual revenues collected from customers can differ to the allowed regulatory revenues. This can give rise to timing differences.

As detailed in Note 2 of the financial statements, for 'TNUoS' revenues we act as agent for the GB Transmission Owners and for certain revenues relating to the Interconnector Interconnexion France-Angleterre ('IFA'). As agent we recognise an asset or liability for such timing differences.

BSUoS revenues are based on daily calculated tariffs allowing revenues collected to be in-line with the regulatory allowed revenues.

In summer 2020, the ongoing Covid-19 pandemic resulted in higher than usual BSUoS costs due to shifts in demand and this happened at the same time as record levels of renewable generation. Ofgem approved CMP345, an industry support scheme, to defer the impact of part of the increase in balancing system costs in to 2021/22. This resulted in £21m under-recovery of BSUoS collections which is reported within adjusted operating profit for 2020/21.

Consolidated income statement commentary

	Years ended 31 March	
	2021 £m	2020 £m
Revenue	2,127	1,651
Operating costs	(2,086)	(1,515)
Total operating profit	41	136
Finance income	1	3
Finance costs	(2)	(4)
Profit before tax	40	135
Taxation	(7)	(27)
Profit after tax	33	108

Revenue

Revenue for the year ended 31 March 2021 was £2,127m (2020: £1,651m). The ESO is the system operator for Great Britain, which involves the procurement of services to balance the electricity transmission network. For this activity the company applies a BSUoS charge, which is payable by generators and suppliers of electricity. The ESO also holds the role as revenue collection agent for charges to customers on behalf of the owners of the transmission network. These TNUoS revenues are collected in accordance with IFRS 15 and revenues are shown on a net basis. Further details relating to the collection of revenues can be found in Note 2 of the financial statements.

The significant majority of revenue, £2,076m, (2020: £1,609m), is earned through the operation and balancing of the electricity system. This includes recovery of costs directly incurred to balance the electricity system on a 'pass-through basis', recovery of incentive revenue and amounts allowed under our regulatory framework to cover the internal costs of our operations. The ESO Forward Plan incentive scheme outcome for financial year 2020-

21 is expected to be £1m. The scheme rewards performance on progress against an ambitious plan to meet the ESO commitments and targets in relation to the future energy transformation. The scheme is evaluative with the outcome determined by Ofgem following the recommendations of a performance panel including industry stakeholders expected by early August 2021.

TNUoS revenues of £51m (2020: £42m) reflect the recovery of costs we directly incur through the regulatory arrangement, including Ofgem licence fees and property rates. This includes £12m directly recovered from Interconnectors. Further detail on this can be found in note 2 of these financial statements.

Operating costs

Operating costs for the year ended 31 March 2021 were £2,086m. (2020: £1,515m). Of this, £1,875m (2020: £1,317m) relates directly to balancing system costs which have increased due to lower electricity demand and record levels of renewable energy generation being brought onto the transmission network, which requires additional balancing work. Other

costs of our operations of £164m (2020: £160m) included payroll, pensions deficit, licence payments and other running costs. Depreciation and amortisation totalled £47m for 2021 (2020: £38m), driven substantially by depreciation of intangible IT assets.

Under the separation agreement with National Grid Electricity Transmission Plc, and in accordance with the regulatory requirements set by Ofgem, the company paid £12m of pension deficit contributions into the National Grid Electricity Group of the Electricity Supply Pension Scheme (NGEG of ESPS).

Net finance costs

For the year ended 31 March 2021, net finance costs before exceptional items and remeasurement were £1m (2020: £1m). This includes interest paid on the fixed term loan to National Grid plc offset by interest received on centrally managed treasury banking arrangements. The Company also pays fees to external providers of working capital facilities. Interest is also charged on balances owed from or to external customers during the normal course of business.

Taxation

The tax charge on profits before exceptional items and remeasurements was £7m (2020: £27m) at a rate marginally lower than the standard UK tax rate of 19% due to adjustments in relation to prior year as a result of the submitted tax computation for 31 March 2020.

Consolidated statement of financial position

Commentary	Years ended 31 March	
	2021 £m	2020 £m
Non-current assets	488	336
Current assets	747	732
Total assets	1,235	1,068
Current liabilities	(859)	(666)
Non-current liabilities	(45)	(104)
Total liabilities	(904)	(770)
Net assets	331	297

Non current assets

Deferred tax liabilities

The net deferred tax liability as at 31 March 2021 is £18m (2020: £13m). This is an increase in liability of £5m, predominantly driven by a £5m movement due to deferral of TNUoS revenues.

Property, plant and equipment

The total net book value (NBV) of property, plant and equipment was £128m (2020: £128m) as at 31 March 2021, including capital additions of £35m.

Intangible assets

The total NBV of intangible assets was £250m as at 31 March 2021 (2020: £208m). This included additions of £54m in year relating to software projects, offset by £35m of amortisation.

Remaining amount within non-current assets relates to TNUoS revenue timing difference (£109m under-recovery) and investment in joint venture (£0.6m relating to Coreso SA).

Current assets

Trade and other receivables

Trade and other receivables totalled £531m at 31 March 2021, (2020: £367m), with the main component being accrued income of £361m (2020: £253m). The accrued income element comprises of TNUoS billing accruals of £134m with the remaining balance including BSUoS accruals of £194m and other accruals of £33m.

Trade receivables of £106m (2020: £68m) were held as at 31 March 2021, net of £17m of bad debt provision. £15m of bad debts already provided for were written off in year (majority of which related to Margree Wind Farm).

Current liabilities

Trade and other payables

Trade and other payables as at 31 March 2021 were £737m (2020: £534m), chiefly relating to £288m (2020: £174m) of trade payables and other accruals; this was mainly generated by £159m of BSUoS cost accruals at the year end.

Deferred income as at 31 March 2021 of £180m (2020: £128m) was generated through the

deferral of TNUoS revenues. This is caused by differences in our forecast TNUoS usage for billing and actual customer usage.

Social security and other taxes as at 31 March 2021 of £133m (2020: £161m) related predominantly to £132m of quarterly VAT payable. The Company is part of the National Grid Group VAT group and settles VAT quarterly. This leads to the large VAT liability reflecting TNUoS and other charges from National Grid Electricity Transmission not being subject to VAT.

Capital contributions

Capital contributions for the year ended 31 March 2021 were £85m. These relate to revenues collected on behalf of the Transmission Owners for construction projects for which the ESO have not yet been invoiced.

Deferred tax liabilities

The net deferred tax liability as at 31 March 2021 is £18m (2020: £13m). This is an increase in liability of £5m, predominantly driven by a £5m movement due to deferral of TNUoS revenues.

Net debt

The net debt position as at 31 March 2021 was cash positive at £96m (2020: £244m) and is detailed further on the following page.

Provisions

Total provisions decreased by £10m, in the year, driven by the utilisation of the restructuring provision created in 2019. The final balance for the year was £2m relating solely to restructuring.

Non-current liabilities

Other non-current liabilities totalled £27m (2020: £90m) as at 31 March 2021. This consisted of £25m application fees (relating to advance payments by customers for feasibility studies and connections) and £2m deferred income (relating to TNUoS revenue), further details of these timing differences can be found in Note 2 of the financial statements.

Cash flow statement commentary

Cash inflows and outflows are presented to allow users to understand how they relate to the day-to-day operations of the business (operating activities); the money that has been spent or earned on assets in the year, including acquisitions of physical assets or intangible assets; and the cash raised from debt or share issues and other loan borrowings or repayments (financing activities).

Reconciliation of cash flow to net debt		
	2021 £m	2020 £m
Cash generated from operations	(69)	314
Net capital expenditure	(88)	(89)
Business net cash flow	(157)	225
Net interest paid	(2)	-
Tax paid	10	(27)
Net proceeds from loans	160	225
Acquisition of business	-	(302)
Proceeds from share issue	-	330
Increase in cash and cash equivalents	11	1
(Decrease)/increase in financial investments	(160)	364
Increase in borrowings and related derivatives	-	(121)
Net interest received on the components of net debt	1	-
Net debt decrease	(148)	244
Opening net debt	244	-
Closing net debt	96	244

For the year ended 31 March 2021 cash flow from operations was an outflow of £(69)m. This was driven by operating profit adjusted for depreciation, amortisation, and provisions of £79m offset by a £(149)m working capital outflow, largely driven by an increase in accrued income. ESO currently bears cash flow risk relating to the timing of collection of TNUoS revenues. This resulted in under collection of £109m compared with an over collection of £61m in 2020. On implementation of RIIO-2, this cash flow risk will transfer to onshore Transmission Owners.

Our electricity system operations are subject to a multi-year regulatory agreement.

Net capital cash expenditure

Net capital investment was £88m (2020: £89m) in the year to date 31 March 2021. This is mostly software and computer hardware within IT system development projects.

Net interest paid

The net interest paid was £2m (2020; £nil).

Dividends paid

No dividend was declared by the year end 31 March 2021, as a result no dividend amount has been included within the financial statements. On 20 July 2021, reflecting the financial position of the ESO and in light of our residual dividend policy, the Board recommended a final dividend of £67m to be paid in August 2021 (2020: £nil).



Section 172 statement

The ESO aims to achieve high standards of leadership and governance. For the year ended 31 March 2021, under The Companies (Miscellaneous Reporting) Regulations 2018, we have applied the Wates Corporate Governance Principles for Large Private Companies, set out in the Corporate Governance section on page 50. These serve as a framework to demonstrate how Directors have had regard for the matters set out in section 172(1)(a) to (f) of the Companies Act 2006 (“CA 2006”) when performing their duties.

The Board considers what is most likely to promote the success of the Company long-term; whilst considering the interests of the ESO’s employees and all other stakeholders. The ESO’s corporate governance principles provide a framework for the Board in managing long-term strategic business decisions that promote the success of the Company, while having regard to the matters set out in section 172(1)(a) to (f) of the CA 2006.

Illustrations of how the s172 factors have been applied by the Board can be found below and throughout the Strategic Report:

s172 factor	Key examples	Page
Consequence of any decision in the long term	<p>The ESO's strategy is based on a long-term vision for Britain's electricity system to be able to run on purely zero carbon electricity by 2025, supporting the UK's 2050 net zero commitment. This allows the Board to explore opportunities that align with this purpose, whilst offering greater value to consumers.</p> <p>Each year, the Board approves the ESO's annual plan and monitors implementation through regular reporting throughout the year. In the current year, the Board has overseen the implementation of the first stage of the RIIO-2 business plan, our ambitious 5-year business plan.</p>	26 & 27
Interests of employees	<p>The Board understands the importance of its employees to the long-term success of the ESO and promotes meaningful engagement and transparency with employees.</p> <p>The importance of connection and communication with employees has been highlighted during the Covid-19 pandemic. Numerous initiatives to improve employee relations and improve working life for our workforce have been put in place over the last year, and following positive feedback, have become part of our ways of working. Our annual employee survey engagement and enablement scores demonstrate a substantial improvement over the prior year.</p> <p>The Board and committees consider how decisions will impact ESO employees and monitor initiatives to promote wellbeing, inclusion and diversity.</p>	21 & 24 - 25
Fostering business relationships with suppliers, customers and others	<p>As part of its decision-making process the Board and its committees consider the potential impact of decisions on relevant stakeholders as well as broader factors, such as the pace of change within the energy industry, and the evolving economic, political and market conditions. There are often trade-offs between different stakeholders over the longer-term and the Directors consider this as they evaluate decisions.</p> <p>The ESO conducts regular surveys to ask about customer satisfaction with our service, and plans are in progress to improve this.</p>	22 & 50

s172 factor	Key examples	Page
Impact of operations on the community and the environment	<p>Proper stakeholder engagement takes place both at an operational and Board level. The Directors are supported in considering stakeholders through the inclusion of stakeholder feedback gained at an operational level in Board papers, which are reviewed and considered by all Directors. The Board also regularly invite representatives of key stakeholders to meet with them to discuss matters under consideration and listen to any concerns.</p> <p>The ESO is undertaking some transformational projects, which will deliver significant positive impacts for consumers. The proposals have been developed with stakeholders and industry through a variety of consultations and interactions.</p>	16 & 28
Maintaining a reputation for high standards of business conduct	<p>The ESO is proud of its reputation for operating one of the most reliable electricity systems in the world. Our licence to operate is dictated by the way we are perceived by stakeholders, so the Board gives high priority to maintaining a reputation for high standards of business conduct. It identifies and monitors external developments likely to impact on our reputation and ability to run our business as a good corporate citizen.</p> <p>In October, the ESO adopted the National Grid Group Responsible Business Charter to bring a greater focus on responsibility into our actions and decision-making.</p>	28 - 30
Acting fairly between members	<p>National Grid Electricity System Operator Limited is a wholly owned subsidiary of National Grid Holdings One plc. Our ultimate parent company is National Grid plc.</p> <p>National Grid plc has established a committee, the ESO Committee, to provide shareholder oversight of the business and respect the ESO's licence restrictions on sharing of System Operator Function Information (SOFI).</p> <p>Regular monthly and quarterly reports provide effective shareholder oversight of the Company as a legally separate entity, whilst remaining a valued part of the National Grid Group.</p>	51

Corporate governance



1 Purpose and leadership

An effective board develops and promotes the purpose of the Company, and ensures that its values, strategy and culture align with that purpose.

Purpose

We operate the UK's network of high voltage electricity wires second to second, supplying homes and businesses with affordable energy they can rely on. We make sure that Great Britain has the energy it needs by making sure supply meets demand every second of every day.

Strategy

The strategic focus of the Board has been to oversee plans for the implementation of the Company's ambitious RIIO-2 business plan from 1 April 2021 and driving delivery of an electricity system that helps the UK meet its net zero commitments.

The Board concurrently managed the system balance and operability through the sudden impact of the Covid-19 Pandemic, which brought unprecedented challenges. The ESO's robust plans ensured that we have kept Great Britain's lights on throughout.

Considerable effort has gone into ensuring that the strategy of the ESO continues to align with our purpose and that our business and people are organised and deployed in a way that ensures the future success of the ESO and the UK energy market in the long term. For further details in this regard, please refer to link [here](#).

2 Board composition

Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the Company.

Balance, Diversity, Size and Structure

As of 20 July 2021, the Board comprises a majority of five Non-Executive Directors (NEDs) and three Executive Directors. The Chair of the Board is also the Executive Director of the ESO; this is considered appropriate for ESO as a subsidiary company of a large group.

The NEDs bring a range of experience, perspective and challenge from outside the energy industry. In the year, the Board appointed two new NEDs adding experience in technology, digital transformation and engineering. The size and composition of the Board is appropriate to the ESO's size, nature and complexity of the business. It also complies with the requirements of our licence.

There are an equal number of male and female Directors on the Board. The Board recognises that diversity is a challenge for the energy sector and makes diversity an integral part of its agenda. A biography for each Board director can be found on [page 8](#).

There is open debate and constructive challenge at meetings, with Board members demonstrating good engagement with the business and a sound understanding of the ESO's strategy, risks and challenges. As the business must balance costs against the prudent management of risks inherent in the operation of the electricity system, there are often trade-offs between different stakeholders over the longer-term and the directors carefully consider this as they evaluate decisions.

The NEDs bring independent and objective judgement to Board deliberations, challenging and monitoring performance of executive management and obtaining assurance that the Company's legal and regulatory requirements have been met.

The Directors have equal voting rights when making decisions, except the Chair, who has a casting vote in the event of a tie. All Directors have access to the advice and services of the Company Secretary and may also take professional advice at the Company's expense.

All Board appointments are made in consultation with our Shareholder and in line with National Grid's Procedure for the Appointment of Directors to Subsidiary Companies.

Effectiveness

Directors update their knowledge and familiarity with the ESO by meeting with senior management (and by attending company events and operations) predominantly performed virtually in 2020/21 due to the Covid-19 restrictions. Induction materials and briefings are provided to new Directors.

The Board receive updates and presentations on key operational matters and specific initiatives within the business and the wider operating environment to strengthen their knowledge and understanding of the business and operational matters. These visits and briefing sessions create further links between the business and the Board room.

At the end of March 2021, the Board instigated an effectiveness evaluation facilitated by an external specialist. The objective is to stimulate open and honest discussion by the Board with a view to identifying opportunities for Board development in 2021/22.

3 Director responsibilities

Accountability

The board and individual directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should support effective decision-making and independent challenge.

The Board recognises the importance of having a strong corporate governance framework and is collectively responsible for governance and oversight of the business, and compliance with all relevant laws and regulations, including compliance with its obligations under its ESO Licence. To facilitate this, we established a comprehensive governance framework, which forms part of the wider National Grid plc governance framework and is aligned, as required and is applicable, to the company.

The Board had six principal meetings in the year. These are scheduled in advance providing all directors with sufficient notice to attend. Board attendance is set out below and expressed as the number of meetings attended out of the number possible or applicable for the individual director during the year to 31 March 2021.

Attendance

		Attendance
John Linwood	Non-Executive Director (appointed 16 June 2020)	5 of 5 (100%)
Baroness Gillian Merron	Non-Executive Director	6 of 6 (100%)
Regina Moran	Non-Executive Director (appointed 1 August 2020)	4 of 4 (100%)
Hannah Nixon	Non-Executive Director	6 of 6 (100%)
Kayte O'Neil	Head of Markets - ESO	6 of 6 (100%)
Paul Plummer	Non-Executive Director	6 of 6 (100%)
Fintan Slye (Chair)	Executive Director - ESO	6 of 6 (100%)
Gregg Smith	Finance Director - ESO (appointed 4 May 2020)	6 of 6 (100%)

Additional supplementary Board meetings were scheduled to allow focus on urgent matters, there were 17 in 2020/21 covering topics such as Covid-19 response, RIIO-2 and the Demand Forecasting investigation. All Directors were either present or provided feedback to the Chair prior to the meeting. In response to the Covid-19 pandemic, the Board heightened its focus on system operation, financial sustainability and staff safety and wellbeing through additional fortnightly meetings.

The Board determines the strategic direction of the ESO, establishes policies for corporate management, makes decisions on major initiatives and ensures the leadership is in place to implement these policies and decisions.

The Board operates a forward agenda of standing items appropriate to the operating and reporting cycles and receives regular and timely information on all key aspects of the business, including risks and opportunities, operations, financial and regulatory reporting, market conditions, relationships with regulatory bodies and human resources,

legal, compliance, and regulatory matters, supported by a KPI Scorecard allowing supervision of safety, financial performance, the organisation and customer satisfaction.

The Directors have a clear understanding of their roles and responsibilities. The five NEDs have no business or relationship with the ESO or the wider National Grid Group that would compromise their influence or objectivity.

The ESO is proud of its reputation for operating one of the most reliable electricity systems in the world. Our licence to operate is dictated by the way we are perceived by stakeholders, so the Board gives high priority to maintaining a reputation for high standards of business conduct. It identifies and monitors external developments likely to impact on our reputation and ability to run our business as a good corporate citizen. For more information see our section on acting as a responsible business on [page 28](#).

Areas of focus in 2020/21

Governance	<ul style="list-style-type: none"> Formalising the new Health, Safety and Wellbeing committee Updating the Terms of Reference and members of the ESO Board committees Establishing the remit of the first Board evaluation review
Strategy	<ul style="list-style-type: none"> ESO Innovation Strategy 2020/1 Early Competition Plan Offshore coordination project Resourcing both people and technology
Finance	<ul style="list-style-type: none"> Capital Expenditure investments Approval of the annual financial plan Financial sustainability and industry support schemes
Risk and opportunity	<ul style="list-style-type: none"> System Operator governance review Assessment of the Energy White Paper Assessment of the impact of Brexit Changes to the UK's energy landscape UK's net zero carbon commitment by 2050
Corporate Social Responsibility	<ul style="list-style-type: none"> Commitment to being a responsible business including more transparent reporting ESO Community Fund and volunteering commitment Delivering on our 2025 zero carbon operation ambition

Integrity of information

Financial information is collated by our finance function from its accounting systems to enable the Board to assess financial performance. Internal control systems help ensure the financial information generated is reliable, consistent, timely and complete. Financial information is externally audited by Deloitte LLP annually and financial controls are routinely reviewed by the National Grid’s central internal Assurance and Corporate Audit functions. Other key information is prepared by the relevant business and internal functions, which are also subject to periodic reviews by the ESO’s Assurance function.

Committees

The Board has delegated certain governance responsibilities to Committees that have the knowledge and experience to make recommendations to the Board, each of which have documented terms of reference. Each committee is chaired by a NED and the NED members provide independent challenge and support for effective decision making.

The Board and its committees regularly review terms of reference to ensure that they remain fit for purpose, are adapted to promote good governance and meet the requirements of the Company as they evolve. At each Board meeting, directors receive reports from the Chairs of the Committees that have met in the period on the agenda, key discussion items, activities and recommendations.

Audit & Risk Committee	<p>During the year, the Terms of Reference of the Audit Committee were expanded to cover risk, to assist the Board in fulfilling its responsibility for the ESO’s risk appetite and ensuring that sound risk management and internal control systems are maintained. The name changed to the Audit & Risk Committee (ARC).</p> <p>The ARC monitors the effectiveness of internal controls; risk management; integrity of financial statements; and the performance of the internal Assurance and Corporate Audit department and independent auditor.</p>
Nominations Committee	<p>The Nominations Committee makes sure the Board remains balanced and effective and that its structure, composition and skills align to the ESO’s strategic objectives, and has due regard for diversity. The Committee’s primary objective is to identify and evaluate candidates for future NED appointments and in doing so, it takes advice from external recruitment consultants. In 2020, the Committee led the process that resulted in the new NEDs, John Linwood and Regina Moran, being appointed to the Board.</p> <p>During the year, the Terms of Reference of the Nominations Committee were expanded: (i) to review the remuneration policies and benefits framework for ESO employees to ensure that they support the strategic objectives, culture and values of the Company (and where appropriate, make recommendations to the Shareholder in respect of this); (ii) to provide twice annual performance evaluation feedback on the Chair of the Board to the Shareholder and on the ESO Executive Team to the Chair of the Board.</p>
Business Separation Compliance Committee	<p>The Business Separation Compliance oversees the duties and tasks of the ESO Business Separation & EMR Compliance Officer and for overseeing compliance with the business separation licence conditions.</p>
Health, Safety & Wellbeing Committee	<p>The ESO is dedicated to ensuring the highest standards of health, safety and wellbeing for all staff, going beyond compliance with legal requirements and adopting a good practice model that benefits everyone. To support the Board with this ambition, it established the Health, Safety & Wellbeing Committee during November 2020, with responsibility for nurturing and promoting a positive attitude to health, safety and wellbeing as in integral part of the ESO’s activities and to maintain an overall assessment of the key ESO health, safety and wellbeing specific risks.</p>

Below is a summary of the committee structure and members.

	Audit & Risk	Compliance	Nomination	Health, Safety & Wellbeing
John Linwood*			●	●
Baroness Gillian Merron*		●	●**	
Regina Moran*	●			●**
Hannah Nixon*	●**		●	
Kayte O'Neil	●			
Paul Plummer*		●**		●
Fintan Slye			●	
Gregg Smith		●		

*NED **Chair

The Board also delegates certain powers and responsibilities to the following:

Electricity System Operator Executive Team

ESO Executive Team meets at least weekly and comprises individuals responsible for strategic business units and key functions. Duties include formulating strategy proposals for Board approval and ensuring the strategy is implemented in a timely and effective manner. The Executive Team receives reports from its two sub-committees: ESO Investment Committee and Incentive Performance Committee. ESO Executive Team makes the values, strategy and culture align, are implemented and are communicated consistently to our employees. The gender balance in the ESO Executive Team is 50/50.



4 Opportunity and risk



The Board should promote the long-term sustainable success of the Company by identifying opportunities to create and preserve value, and establish oversight for identification and mitigation of risks.

Opportunity

The ESO's strategy is based on a long-term vision for Britain's electricity system to be able to run on purely zero carbon electricity by 2025, supporting the UK's 2050 net zero commitment. The Board explores opportunities that align with this purpose - such as Early Competition and Offshore Coordination, supported by the RIIO-2 cost pass-through mechanism.

Major opportunities in excess of thresholds are considered and approved by the Board in accordance with the Company's Articles of Association and Delegated Authorities. Interesting and significant initiatives are presented to the Board alongside these.

Risk

Effective risk management is fundamental to our long-term success. The Strategic Report on [page 23](#) includes an assessment of the ESO's principal risks and uncertainties and describes our internal controls and risk management.

At Board level, oversight for the identification and mitigation of risk is delegated to the Audit & Risk Committee. The ESO has been on a significant programme of change over the last two years for the management of risk. This has seen the implementation of a new risk framework and a move to a new risk management system. In 2021, work moves to focus on the quality of information and effectiveness of the controls.

The Audit & Risk Committee reviews the ESO's internal control and risk management systems and receives reports from management on the effectiveness of the established systems and conclusions of any testing carried out by internal and external auditors. The Committee approves the annual internal audit and ESO assurance plan, ensuring that these are aligned to the key risks of the business. The plans are sufficiently flexible, to help react to and address new and emerging risks. The Committee receives regular summaries of this work and monitors and reviews the effectiveness of these activities and any mitigating action plans in the overall context of the ESO's risk management system. The Audit & Risk Committee's Chair is responsible for keeping in touch on a continuing basis with key people involved in the ESO's governance including the ESO's Finance Director, Head of Corporate Audit and the external audit lead partner.

The Board approves the Company's risk appetite and undertakes an assessment of the Company's risk management framework annually to ensure that it remains appropriate.

5

Remuneration



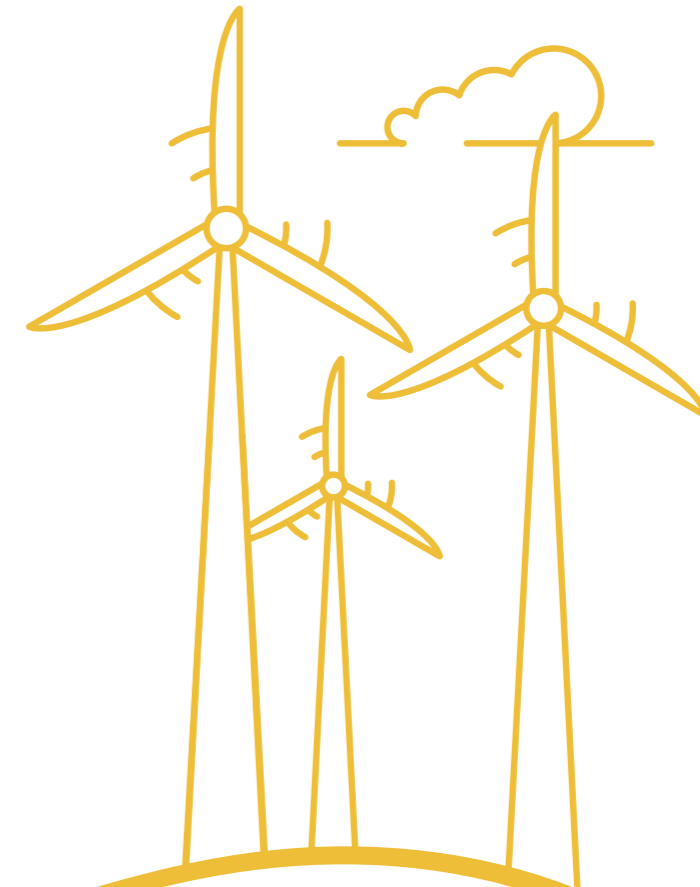
A Board should promote executive remuneration structures aligned to the long-term sustainable success of a company, taking into account pay and conditions elsewhere in the Company.

Directors are not separately remunerated for their Board role, except for the NEDs, who are paid an annual fee to attract and retain a balanced skill-set and provide strong stewardship and governance.

Directors' remuneration is determined in accordance with National Grid's remuneration policies for employees. See the Annual Report and Accounts of National Grid plc for further information. In accordance with the requirements of the ESO licence, incentivisation of the executive Directors is linked to the performance of ESO only.

The ESO is committed to ensuring all employees are paid fairly for the role they undertake and our gender pay data is scrutinised and discussed by the Board at least annually. For further details, please refer to the Company's latest Gender Pay Gap Report which can be found [here](#).

In November 2020, the Board reviewed the Terms of Reference of the Nomination Committee, expanding the Committee's responsibilities to review, and where appropriate, make recommendations to the Shareholder in respect of the remuneration policies and benefits framework for all ESO employees to ensure that they support the strategic objectives, culture and values of the Company.



6

Stakeholder relationships and engagement



Directors should foster effective stakeholder relationships aligned to the Company's purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions.

The Board promotes meaningful engagement and transparency with employees, customers and external stakeholders and considers their views when taking decisions.

Many of our business initiatives require detailed stakeholder input, such as our Future Energy Scenarios 2020 publication and our Network Options Assessment. We engage with the wider stakeholder community via our core channels, which include website, social media, live events, webinars, knowledge shares and newsletters.

We run a UK and European public affairs engagement programme to engage with and inform key industry stakeholders. We are members of industry collectives such as the Energy Networks Association and Powering Past Coal Alliance.

Shareholder

As a wholly owned subsidiary, the Board duly considers the views and interests of its ultimate Shareholder, National Grid plc, as part of any major decisions and transactions, where this is appropriate in the context of its licence obligations around legal separation.

National Grid Group, as ultimate shareholder of the ESO, is responsible for ensuring the long-term viability and prudent financial management of the National Grid Group. Arrangements are in place to both enable appropriate Group oversight but also enable the ESO to operate sufficiently independently within the National Grid Group.

The Articles of Association and Matters Reserved to the National Grid Group Board describe the remit of the public limited company (PLC) and are available on the National Grid website. To bring this interaction to life, the areas of ESO activity that have visibility or require approval at Group Board level include things like:

- Approval of the ESO's annual budget;
- Review and approval of the ESO's three year rolling financial forecast;
- Visibility of the ESO's financial performance against its annual business plan;
- Visibility of the ESO's principal risks;
- Approval of any material extension of the ESO's activities into new business areas or any decision to cease to operate any part of the ESO's business;

- Authorisation of changes affecting the capital structure of the ESO;
- Approval of the long-term strategic objectives of the ESO and any major changes to the size and composition of the ESO Board and its committees; and
- Unforeseen issues that have significant or material impact on the Group (e.g. financial, reputational or principal risks).

To support operational and managerial separation of the ESO, and independence of the ESO Board, there is a Group level committee, the ESO Committee. The ESO Committee ensures all ESO ringfenced information required to support good corporate governance by the ultimate shareholder is viewed separately from other subsidiaries in the National Grid portfolio. The ESO Committee is not involved in the day-to-day operation of the ESO.

Matters reserved for the National Grid Group Board are published on the National Grid website [here](#).

The NEDs hold an annual meeting with the Chief Executive of National Grid plc. There is also an annual meeting held between the respective Chairs of the National Grid plc Audit Committee and ESO Audit and Risk Committee.

The Strategic Report was approved by the Board of Directors on 20 July 2021 and signed on its behalf by



Fintan Slye, Chair

For the purposes of the UK Companies Act 2006, the Directors present their report along with the audited consolidated financial statements of the Company for the year ended 31 March 2021, which comprises the Corporate Governance Statement on page 42 and the Statement of Directors' Responsibilities on page 55.

The Strategic Report sets out those matters required to be disclosed in the Directors' Report which are considered to be of strategic importance. Further details of matters required to be included in the Directors' Report.

Directors

The Directors of the Company who were in office during the year and up to the date of signing the financial statements were:

Fintan Slye	
Regina Moran (NED*)	Appointed on 1 August 2020
John Linwood (NED*)	Appointed 16 June 2020
Baroness Gillian Merron (NED*)	
Hannah Nixon (NED*)	
Kayte O'Neill	
Paul Plummer (NED*)	
Roisin Quinn	Resigned on 30 November 2020
Gregg Smith	Appointed 4 May 2020
Claire Tuckman	Resigned 4 May 2020

*Non-Executive Director

Directors' indemnities and insurance

The Company has made qualifying third-party indemnity provisions for the benefit of its Directors during the year; these remain in force at the date of this report.

Principal activities and business review

A full description of our principal activities, business, key performance indicators and principal risks and uncertainties is contained on pages 11 - 33 of this report.

Material interests in shares

National Grid Electricity System Operator Limited is a wholly owned subsidiary undertaking of National Grid Holdings One plc. The ultimate parent company of National Grid Electricity System Operator Limited is National Grid plc.

Dividends

In line with the Board's residual Dividend policy, the Board is recommending a final dividend of £67m for the year to 31 March 2021 to be paid in August 2021 (2020: £nil).

Share capital

The share capital of the company remains unchanged. See note 17 of the financial statement for further details.

Articles of association

The Company's Articles of Association may be amended by a special resolution of the Company's shareholders. The current Articles were adopted by shareholders on the date of incorporation, 16 October 2017.

Conflicts of Interest

The Company's Articles permit the Board to consider and, if deemed fit, authorise situations where a Director has an interest that conflicts, or may possibly conflict, with the interests of the Company. If a Director becomes aware that they have an interest that may arise in a conflict, they are required to notify the Board. Internal controls are in place to make sure that any related party transactions involving Directors are conducted on an arm's length basis. Directors have a duty to update changes to these conflicts. The Board considers the procedures in place for reporting and considering conflicts of interest are effective.

Political donations

During the year, the Company made no political donations.

Research and development

Expenditure on research and development was £2.6m (2020: £2.7m) during the year.

Future developments

Details of future developments are contained in the Strategic Report.

Business relationships

Details of how the Directors have had regard to the need to foster our business relationships with suppliers, customers and other stakeholders and their effect on the decisions taken by the Company during the financial year are contained in the Strategic Report on pages 28 - 33.

Employee engagement

The Directors understand the importance of the ESO's employees to the long-term success of the Company. Details of how the Directors have engaged with employees and have had regard to employee interests in their decision making is contained in the Strategic Report on pages 24 - 25 which is incorporated by reference into this report. The average number of people employed by the Company during the year was 695.

Diversity policy

The ESO does not discriminate on the grounds of age, colour, disablement, marital status, race, religion, gender or sexual orientation. Diversity and Inclusion continues to form a core part of the ESO's business strategy. We rely on the diversity of our employees to form the foundation of a strong and dynamic company. See [page 23](#) for further details. Women represent 50% of the ESO Board and 50% of our Executive Team. Overall, woman make up 35% of our workforce.

Fair and appropriate remuneration

We are voluntarily reporting our ESO Chair to Median remuneration ratio which is 10:1. The ratio is based on total pay and taxable benefits (2020/21) and comprises salary, pension, and other benefits including an estimated vesting value for the 2018 Long Term Performance Plan award which is expected to vest in early July 2021. Excluding this estimated Long Term Performance Plan award the median pay ratio is 6:1.

Energy and carbon

Details of the Company's scope 1 and scope 2 carbon emissions by source are detailed below:

tCO2e	2019/20	2020/21
Buildings	1,479	1,336
Transport	1,424	118
Total	2,902	1,455

Disclosure of information to auditors

The auditors have made the requisite enquiries, and so far as the Directors in office at the date of the signing of this report are aware, there is no relevant audit information of which the auditors are unaware. Each Director has taken all reasonable steps to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

Post balance sheet events

On 9 April 2021, the ESO informed industry parties that it had under-billed customers by c.£43m for Balancing Service costs incurred in 2020/21. A modification to the Connection and Use of System Code (CUSC) was proposed by one market participant proposing that the method of invoicing such costs be amended. This amendment was upheld by Ofgem on 24 May 2021.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

Going concern

The ESO Board has a reasonable expectation that the Company has adequate resources to continue in the operational existence for the foreseeable future. During the financial year the Company has carefully considered the impact of Covid-19 and the impact on not just the energy industry but to the financial position of the Company as a result of unprecedented changes. Further details can be found within the Basis of Preparation on [page 63](#). Accordingly, the financial statements set out on [pages 60 - 61](#) have been prepared on the going concern basis.

Acknowledgement

Due to the impact of the Covid-19 pandemic, this year has been particularly challenging for all. The Directors wish to convey their appreciation to all ESO employees for their continued commitment and contribution to deliver our goals.

The Directors would also like to extend their thanks to all other key stakeholders for their continued support of the Company and their confidence in its management.



Fintan Slye
Chair

20 July 2021

National Grid Electricity System Operator Limited
1-3 Strand, London WC2N 5EH
Registered in England and Wales Number:
11014226

Introduction to the financial statements

Throughout these financial statements, we have provided explanations of the disclosures and why they are important to the understanding of our financial performance and position.

Notes

Notes to the financial statements provide additional information required by statute, accounting standards or other regulations to assist in a more detailed understanding of the primary financial statements. In many notes, we have included an accounting policy that describes how the transactions or balance in that note have been measured, recognised and disclosed. The basis of preparation section provides details of accounting policies that apply to transactions and balances in general.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

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 International Financial Reporting Standards (IFRSs) as adopted by the European Union and, FRS 101. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing the company 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 UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

In preparing the financial statements, International Accounting Standard 1 requires that Directors:

- Properly select and apply accounting policies;
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;

- Provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- Make an assessment of the company's ability to continue as a going concern.

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

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the National Grid ESO website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

On behalf of the Board



Gregg Smith
Finance Director

20 July 2021

Independent Auditor's report to the members of National Grid Electricity System Operator Limited

Report on the audit of the financial statements.

Opinion

In our opinion the financial statements of National Grid Electricity System Operator Limited (the 'company'):

- Give a true and fair view of the state of the company's affairs as at 31 March 2021 and of its income statement for the year then ended;
- Have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- Have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- The income statement;
- The statement of comprehensive income;
- The statement of changes in equity;
- The statement of financial position;
- The cash flow statement; and
- The related notes 1 to 23 of the financial statements.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

In auditing the financial statements, we have concluded that the 'Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern basis for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the Directors with respect to going concern are described in the relevant sections of this report.

Other Information

The other information comprises the information included in the Annual Report, other than the financial statements and our auditor's report

thereon. The Directors are responsible for the other information contained within the annual report. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

Responsibilities of directors

As explained more fully in the 'statement of Directors' responsibilities, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless 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

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. 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.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

We considered the nature of the Company's industry and its control environment, and reviewed the Company's documentation of their policies and procedures relating to fraud and compliance with laws and regulations. We also enquired of management about their own identification and assessment of the risks of irregularities.

We obtained an understanding of the legal and regulatory framework that the Company operates in, and identified the key laws and regulations that:

- Had a direct effect on the determination of material amounts and disclosures in the financial statements. These included UK Companies Act, FRS 101 and tax legislation; and
- Do not have a direct effect on the financial statements but compliance with which may be fundamental to the Company's ability to operate or to avoid a material penalty. These included the Company's operating licence and environmental regulations.

We discussed among the audit engagement team including relevant internal specialists such as tax, valuations, pensions, IT and Treasury specialists regarding the opportunities and incentives that may exist within the organisation

for fraud and how and where fraud might occur in the financial statements.

In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override. In addressing the risk of fraud through management override of controls, we tested the appropriateness of journal entries and other adjustments; assessed whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluated the business rationale of any significant transactions that are unusual or outside the normal course of business.

In addition to the above, our procedures to respond to the risks identified included the following:

- Reviewing financial statement disclosures by testing to supporting documentation to

assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;

- Performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- Enquiring of management, internal audit and in-house legal counsel concerning actual and potential litigation and claims, and instances of non-compliance with laws and regulations; and
- Reading minutes of meetings of those charged with governance, internal audit reports and reviewing correspondence with relevant regulatory authorities.

Report on other legal and regulatory requirements Opinions on other matters prescribed by the Companies Act 2006

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

- The information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- The strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

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

Matters on which we are required to report by exception

Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

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

We have nothing to report in respect of these matters.

Use of our report

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



Jane Whitlock ACA (Senior Statutory Auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
Birmingham, United Kingdom

20 July 2021

Statement of profit or loss and other comprehensive income

for the year ended 31 March 2021

	Notes	2021 £m	2020 £m
Revenue	2	2,127	1,651
Operating costs	3	(2,086)	(1,515)
Operating Profit		41	136
Finance income	4	1	3
Finance costs	4	(2)	(4)
Total profit before tax		40	135
Tax	5	(7)	(27)
Profit after tax/Profit for the year attributable to owners of the parent		33	108
Total comprehensive income for the year attributable to owners of the parent		33	108

Statement of changes in equity

for the period to 31 March 2021

	Notes	Called up share capital £m	Share premium account £m	Retained earnings £m	Merger Reserve ¹ £m	Total equity £m
At 1 April 2019		—	—	—	—	—
Profit for the year		—	—	108	—	108
Total comprehensive income for the year		—	—	108	—	108
Share-based payments		—	—	1	—	1
Issue of share capital		3	327	—	—	330
Acquisition of investments		—	—	—	(142)	(142)
At 31 March 2020		3	327	109	(142)	297
Profit for the year		—	—	33	—	33
Total comprehensive income for the year		—	—	33	—	33
Equity dividends		—	—	—	—	—
Share-based payments		—	—	1	—	1
Tax on share based payments		—	—	—	—	—
At 31 March 2021		3	327	143	(142)	331

¹Analysis of merger reserve has been provided within note 17.

Statement of financial position

as at 31 March 2021

	Notes	2021 £m	2020 £m
Non-current assets			
Intangible assets	7	250	208
Property, plant and equipment	8	128	128
Investment in joint venture	23	1	—
Other non-current assets	9	109	—
Total non-current assets		488	336
Current assets			
Trade and other receivables	11	531	367
Financial assets and other investments	10	204	364
Cash and cash equivalents	12	12	1
Total current assets		747	732
Total assets		1,235	1,068
Current liabilities			
Borrowings	13	(120)	(121)
Trade and other payables	14	(737)	(534)
Provisions	16	(2)	(11)
Total current liabilities		(859)	(666)

Non-current liabilities			
Other non-current liabilities	15	(27)	(90)
Deferred tax liabilities	5	(18)	(13)
Provisions	16	—	(1)
Total non-current liabilities		(45)	(104)
Total liabilities		(904)	(770)
Net assets		331	297
Equity			
Share capital	17	3	3
Share premium account		327	327
Retained earnings		143	109
Merger Reserve	18	(142)	(142)
Total equity		331	297

The consolidated financial statements set out on **pages 61 - 85** were approved by the Board of Directors and authorised for issue on 20 July 2021. They were signed on its behalf by:



Fintan Slye, Chair
Director



Gregg Smith, Finance

Statement of cash flow

for the year ended 31 March 2021

	Notes	2021 £m	2020 £m
Cash flows from operating activities			
Operating profit		41	136
Adjustments for:			
Depreciation, amortisation & impairment		47	38
Share-based payment charge		1	1
Changes in working capital		(149)	146
Changes in provisions		(9)	(6)
Loss on disposal of property, plant and equipment		—	(1)
Cash generated from operations		(69)	314
Tax paid		10	(27)
Net cash inflow from operating activities		(59)	287
Cash flows from investing activities			
Purchases of intangible assets		(53)	(53)
Purchases of property, plant and equipment		(35)	(37)
Disposals of property, plant and equipment		—	1
Interest received		1	3
Acquisition of business		—	(302)
Net cash flow used in investing activities		(87)	(388)

Cash flows from financing activities			
Proceeds from loans received		—	121
Payments of loans issued to ultimate parent		160	(346)
Proceeds from share issue		—	330
Interest paid		(3)	(3)
Net cash flow from financing activities		157	102
Net increase in cash and cash equivalents		11	1
Cash and cash equivalents at the start of the year		1	—
Net cash and cash equivalents at the end of the year	12	12	1

Notes to the financial statements - analysis of items in the primary statements

1. Basis of preparation and recent accounting developments

Accounting policies describe our approach to recognising and measuring transactions and balances in the year. The accounting policies applicable across the financial statements are shown below, whereas accounting policies that are specific to a component of the financial statements have been incorporated into the relevant note.

This section also shows areas of judgement and key sources of estimation uncertainty in these financial statements. In addition, we have summarised new International Accounting Standards Board (IASB) and EU endorsed accounting standards, amendments and interpretations and whether these are effective

for this year end or in later years, explaining how significant changes are expected to affect our reported results.

National Grid Electricity System Operator's principal activities involve the operation of the electricity transmission system in Great Britain. The Company is a limited liability company incorporated and domiciled in England and Wales, with its registered office at 1-3 Strand, London WC2N 5EH.

These financial statements were approved for issue by the Board of Directors on 20 July 2021. The company meets the definition of a qualifying entity under FRS 100 Application of Financial Reporting Requirements. Accordingly, the company has elected to apply FRS 101 Reduced Disclosure Framework.

The recognition and measurements requirements of EU-adopted IFRS have therefore been applied within these financial statements, with amendments where necessary in order to comply with the Companies Act 2006.

The financial statements have been prepared on a historical cost basis. These financial statements are presented in pounds sterling, which is also the functional currency of the Company. The notes to the financial statements have been prepared on a continuing basis unless otherwise stated.

a) FRS 101 exemptions

As permitted by FRS 101, the company has taken advantage of exemptions from the requirements of IFRS in relation to the following elements:

- Disclosures in respect of share based payment;
- Disclosures in respect of capital management;
- Disclosures required by IFRS 13 '*Fair Value Measurement*';
- Disclosures required by IFRS 7 '*Financial Instruments: Disclosures*';
- Presentation of comparative information in respect of certain assets;
- The effect of standards not yet effective; and
- Related party transactions.

Where required, equivalent disclosures are given in the Group financial statements of National Grid Plc, which are available to the public as set out in Note 22.

b) Going concern

As part of the Board's consideration of the appropriateness of adopting the going concern basis of accounting in preparing these financial statements, the Board has considered the impact of Covid-19 principal risks on the ESO's operations. The ESO Board has assessed the principal risks including by modelling cash flow forecast scenarios. These cash flow scenarios, included a reasonable worst case scenario.

The main cash flow transactions assessed in the forecast scenarios are:

- TNUoS and BSUoS under and over-recoveries collected from or returned to customers in accordance with established regulatory structures, including those arising from Covid-19 support schemes;
- TNUoS timing risk and its transfer to the onshore TO's during FY21 in accordance with RIIO-2; (and the contrary should a reversal of the RIIO-2 Final Determinations following the ongoing CMA appeal occur);

- Significant termination payments;
- Bad debts, including higher bad debt costs than forecast; and
- Payment of proposed dividends to the shareholder.

Having considered the forecast scenarios, the ESO continues to have headroom against its committed external facilities identified in note 13 to the financial statements.

Based on the above, the Directors have concluded the Company is well placed to manage its financing and other business risks satisfactorily, and have reasonable expectation that the Company will have adequate resources to continue in operation for at least 12 months from the signing date of these financial statements. They therefore consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

c) Foreign currencies

Transactions in currencies other than the functional currency of the Company are recorded at the rates of exchange prevailing on the dates of the transactions. At each reporting date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at closing exchange rates. Non-monetary assets are not retranslated unless they are carried at fair value.

Gains and losses arising on the retranslation of monetary assets and liabilities are included in the income statement.

d) Areas of judgement and key sources of estimation uncertainty

Key sources of estimation uncertainty that have significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are as follows:

- Review of residual lives, carrying values and impairment charges for other intangible assets and property, plant and equipment – notes 7 and 8;
- Agency relationship in respect of certain Transmission Network Use of Service revenues, principally those collected on behalf of the Scottish and Offshore transmission operators under IFRS 15 - note 2;
- Outcome of Forward Plan incentive scheme – note 2; and
- Considering the current ongoing impact of the Covid-19 pandemic, levels of impact on bad debt allowances are more uncertain.

e) Accounting policy choices

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates. Information about such judgements and estimations is contained in the notes to the financial statements, and the key areas are summarised below.

The IFRS framework provides certain options available within accounting standards. Choices we have made, and continue to make, include the following:

- Presentational formats: we use the nature of expense method for our income statement and aggregate our statement of financial position to net assets and total equity. In the income statement, we present subtotals

of total operating profit, profit before tax and profit from continuing operations, together with additional subtotals excluding exceptional items and remeasurements. Exceptional items and remeasurements are presented separately on the face of the income statement where applicable.

f) New IFRS accounting standard effective for the year ended 31 March 2021

National Grid plc has also adopted the following amendments to standards, these have been applied to the ESOs accounts since commencement of operations on the 1st of April 2019.

- Amendments to IFRS 16 'Leases – Covid-19 Related Rent Concessions';
- Amendments to IFRS 3 'Business Combinations';
- Amendments to IAS 1 and IAS 8 'Definition of Material';

- Amendments to the References to the Conceptual Framework;
- Amendments to IAS 19 'Employee Benefits' and
- The UK's Financial Conduct Authority announced that LIBOR will cease to exist by the end of 2021, and will be replaced by alternative reference rates. This change does not affect the ESO as there are no hedging relationships currently in place.

g) New IFRS accounting standards and interpretations not yet adopted

The following new accounting standards and amendments to existing standards have been issued but are not yet effective or have not yet been endorsed by the EU:

- IFRS 17 'Insurance Contracts';
- Amendments to IFRS 3 'Business Combinations';

- Amendments to IAS 16 'Property, Plant and Equipment';
- Amendments to IAS 37 'Provisions, Contingent Liabilities and Contingent Assets';
- Amendments to IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors';
- Amendments to IAS 1 'Presentation of Financial Statements' and
- Annual improvements to IFRS standards 2018-2020.

Effective dates remain subject to the EU endorsement process. The Company is currently assessing the impact of the above standards, but they are not expected to have a material impact. The Company has not adopted any other standard, amendment or interpretation that has been issued but is not yet effective.

2. Revenue

Revenue arises in the course of the ordinary activities of the company and principally comprises balancing transmission services.

Balancing transmission services fall within the scope of IFRS 15, 'Revenue from Contracts with Customers'.

The company's role in transmission services is as the system operator for Great Britain, which involves the procurement of services to balance the electricity transmission network and ensuring security and quality of electricity supply across the transmission network.

For this activity the company applies a Balancing Service Use of System ('BSUoS') charge, which is payable by generators and suppliers of electricity.

The ESO also earns revenue through rewards for progress against an ambitious plan to meet its commitments and targets in relation to the future energy transformation. The scheme is evaluative with the outcome determined by Ofgem following the recommendations

of a performance panel including industry stakeholders expected by early August 2021. Ofgem's review process will take place after the financial year end and approval of these financial statements. As such the results presented in these accounts have been adjusted to reflect management's best estimate of the final determination based on performance in prior years and the outcome of the mid-year performance panel. The outcome of the Forward Plan incentive scheme is estimated to be income of £1m for the financial year (2020/21: £1m income).

In its role as system operator, the company is also responsible for the administration of charges to customers on behalf of the owners of the transmission network; National Grid Electricity Transmission Plc, Scottish Power Electricity Transmission Plc, Scottish Hydro Electric Transmission Plc and various Offshore Transmission Owners. Under IFRS 15, this arrangement is considered to result in the company acting as an agent on behalf of the

transmission network owners. Accordingly, revenues are presented on a net basis (amounts collected from customers and consideration paid to transmission network owners). This comprises the entire billing cycle (invoicing and cash collection) and our performance obligation is deemed satisfied when funds have been remunerated to transmission network owners.

These charges are termed Transmission Network Use of System ('TNUoS') charges and relate to use of the transmission network. Use of the transmission network involves the supply of high-voltage electricity. Revenue is billed based on capacity and volumes and where the customer pays upfront, revenues are deferred and released when the relevant transmission network owner has provided their services to the customer.

The company also administers other charges on behalf of transmission network owners principally for construction work they have completed for customer connections.

Electricity transmission in the UK is regulated by Ofgem, which establishes price control mechanisms that set the amount of annual allowed returns for companies operating in the sector. With respect to TNUoS charges, where revenue received differs to the amount of allowable revenue permitted by regulatory agreement, adjustments will be made to future prices to factor in these amounts. Where such differences arise, we recognise either an asset or liability, depending on whether the difference between revenue received is less than or greater than allowable revenue respectively. As part of our regulatory agreements we are entitled to recover certain costs directly from customers (pass-through costs). These amounts are included in the overall calculation of allowed revenue as stipulated by regulatory agreements.

As system operator, we also act as intermediary for the electricity interconnector Interconnexion France-Angleterre ('IFA') in satisfying its regulatory obligations. IFA has a cap on the amount of revenue they are allowed to earn during any financial year (1 April to 31 March). Where actual revenues exceed this cap, the excess must be passed onto consumers. We invoice and recover this amount from IFA and in turn reduce the TNUoS charges due from customers. We recognise an asset for the amounts payable from IFA, and a corresponding liability for the requirement to reduce customer bills, which occurs two financial years after the measurement period.

The following table reconciles disaggregated revenue within the ESO's reportable segments (see note 1).

	UK Electricity System Operation	
	2021 £m	2020 £m
Revenue for the year ended 31 March 2020		
Revenue under IFRS 15:		
BSUoS	2,076	1,609
TNUoS ¹	51	42
Total revenue from continuing operations	2,127	1,651

¹ TNUoS revenues of £51m are reported net of £3,123m consideration paid to transmission network owners. These revenues reflect the recovery of costs borne by the system operator in relation to TNUoS operations.

Total revenue from continuing operations are generated from operations based in the UK.

Analysis of BSUoS revenue by major customer, greater than 10% revenue contribution:

	2021 £m	2020 (Restated) ¹ £m
Customer A	210	189
Customer B	—	169

¹ 2020 customer balances restated to only include BSUoS customers.

No other single customer contributed 10% or more to the ESO's revenue in either 2021 or 2020.

3. Operating costs

Below we have presented separately certain items included in our operating costs. These include a breakdown of payroll costs and fees paid to our auditors.

	2021 £m	2020 £m
After exceptional items and remeasurements		
Depreciation and amortisation	47	38
Payroll costs	55	57
Pensions deficit payments	12	12
Rates and property taxes	1	—
System balancing costs	1,875	1,317
Other ¹	96	91
Continuing operations	2,086	1,515

¹ In 2020, included within Other costs is £3m of other income relating to compensation payments received from a supplier, these settlement payments relate to written off work on a prior periods capital programme. Other costs also includes licence fees of £24m (2020: £23m).

(a) Payroll costs

	2021 £m	2020 £m
Wages and salaries	41	41
Social security costs	6	6
Pension scheme costs	8	9
Share-based payments	1	1
Severance costs (excluding pension costs)	(1)	—
Total payroll costs	55	57

(b) Directors' Emoluments

Key management comprises the Board of Directors of the Company who have managerial responsibility for National Grid Electricity System Operator limited.

	2021 £k	2020 £k
Aggregate Emoluments	1,004	773

Aggregate emoluments excludes social security, pensions and share-based payments.

Post-employment benefits are accruing to one Director under a Group defined benefit scheme. (2020: two). During the year, there were three Directors who exercised share options as part of long term incentive plans of the ultimate parent company, National Grid plc. (2020: three).

The aggregate emoluments for the highest paid Director were £320,000 for 2021; (2020: £181,000); and total accrued annual defined benefit pension at 31 March 2021 for the highest paid Director was £nil (2020: paid to a different director, £34,000 with a lump sum of £104,000).

	31 March 2021 Number	31 March 2020 Number	Monthly average 2021 Number	Monthly average 2020 Number
Electricity System Operator	711	688	695	648

(d) Auditors' remuneration

	2021 £m	2020 £m
Audit services		
Audit of the Company's financial statements	0.2	0.1
Other services supplied		
Other non-audit fees ¹	0.3	0.2

¹ Other services supplied represent fees payable for audit services which are required to be carried out by auditors in relation to the Group's reporting requirements to NG plc. In particular, this includes fees for reports under section 404 of the US Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley), and assurance fees in relation to regulatory returns.

4. Finance income and costs

This note details the interest income generated by our financial assets and interest expense incurred on our financial liabilities.

	2021 £m	2020 £m
Finance income		
Interest income and financial instruments:		
Bank deposits and other financial assets	1	3
Finance costs		
Other borrowings	(2)	(4)
Net finance costs from operations	(1)	(1)

5. Tax

This note gives further details of the total tax charge and tax liabilities, including current and deferred tax. The current tax charge is the tax payable on this year's taxable profits. Deferred tax is an accounting adjustment to provide for tax that is expected to arise in the future due to differences in accounting and tax bases of profit.

The tax charge for the period is recognised in the income statement, the statement of comprehensive income or directly in equity, according to the accounting treatment of the related transaction. The tax charge comprises both current and deferred tax.

Current tax assets and liabilities are measured at the amounts expected to be recovered from, or paid to, the taxation authorities. The tax rates and tax laws used to compute the amounts are those that are enacted or substantively enacted by the reporting date.

The calculation of the ESO's total tax charge involves a degree of estimation and judgement. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. Judgement is made for each position having regard to particular circumstances and advice obtained.

Deferred tax is provided for using the balance sheet liability method and is recognised on temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit.

Deferred tax liabilities are generally recognised on all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. However, deferred tax assets and liabilities are not recognised if the temporary differences arise from the initial recognition of goodwill or from the initial recognition of other assets and liabilities in a transaction (other than a business combination) that affects neither the accounting nor taxable profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based on the tax rates and tax laws that have been enacted or substantively enacted by the reporting date.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient tax profits will be available to allow all or part of the deferred tax asset to be recovered. Unrecognised deferred tax assets are reassessed at each reporting date and

are recognised to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the ESO intends to settle its current tax assets and liabilities on a new basis.

Tax charged to the income statement:

	2021 £m	2020 £m
Total tax charge ¹	7	27

¹ 2020 includes £1m relating to tax rate changes, this is detailed in the table on the following page.

The tax charge for the year can be analysed as follows:

	2021 £m	2020 £m
Current tax charge	2	23
Deferred tax charge	5	4
Total tax charge	7	27

Tax charged/(credited) to equity and other comprehensive income:

The tax charge for the year is higher than the standard rate of corporation tax in the UK of 19%:

	Before exceptional items and remeasurements	After exceptional items and remeasurements	Before exceptional items and remeasurements	After exceptional items and remeasurements
	2021 £m	2021 £m	2020 £m	2020 £m
Profit before tax from continuing operations	40	40	136	136
Profit before tax multiplied by UK corporation tax rate of 19%	8	8	26	26
Effect of:				
Adjustments in respect of prior years	(1)	(1)	—	—
Deferred tax impact of change in UK tax rate	—	—	1	1
Total tax charge	7	7	27	27
Effective tax rate	17.5%	17.5%	20.1%	20.1%

Factors that may affect future tax charges

In the Spring Budget 2021, the UK government announced an increase in the main corporation tax rate from 19% to 25% with effect from 1 April 2023. Since this had not been substantively enacted at the balance sheet date, deferred tax balances as at 31 March 2021 have been calculated at the current main UK corporation tax rate of 19%.

We expect our future deferred tax liabilities to increase reflecting the impact of the rate change. If the amended tax rate of 25% had been used, the deferred tax liability would have been approximately £12m higher.

The Directors will continue to monitor the developments driven by Brexit, the OECD's Base Erosion and Profit Shifting (BEPS) project and European Commission initiatives including fiscal aid investigations. At this time the Directors do not expect this to cause any material impact on future tax charges.

Governments across the world including the UK have introduced various stimuli / reliefs for businesses to cope with the impact of Covid-19 pandemic. The Directors will monitor as the details become available for any that may materially impact our future tax charges.

Tax included within the statement of financial position

The following are the major deferred tax assets and liabilities recognised, and the movements thereon, during the current and prior reporting periods:

Deferred tax liabilities (assets):

	Accelerated tax depreciation	Other net temporary differences	Total £m
	£m	£m	
At 1 April 2019	—	—	—
Acquisition of business	(12)	3	(9)
Charged/(credited) to income statement	(3)	(1)	(4)
At 31 March 2020	(15)	2	(13)
Deferred tax assets at 31 March 2020	—	3	3
Deferred tax liabilities at 31 March 2020	(15)	(1)	(16)
At 1 April 2020	(15)	2	(13)
Charged/(credited) to income statement	(2)	(3)	(5)
At 31 March 2021	(17)	(1)	(18)
Deferred tax assets at 31 March 2021	—	—	—
Deferred tax liabilities at 31 March 2021	(17)	(1)	(18)
At 31 March 2021	(17)	(1)	(18)

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is intention to settle the balances net. The deferred tax balances (after offset) for statement of financial position purposes consist solely of deferred tax liabilities of £18m.

6. Dividends

Dividends represent the return of profits to shareholders. Dividends are paid as an amount per ordinary share held. We retain part of the profits generated in the year to meet future growth plans and meet our gearing target and pay out the remainder per our dividend policy.

Interim dividends are recognised when they become payable to the Company's shareholders. Final dividends are recognised when they are approved by shareholders.

On 20 July 2021, the Board of directors proposed a final dividend of £67m for the year ended 31 March 2021 (2020: £nil).

7. Intangible assets

Intangible assets relate to software, which is written down (amortised) over the period we expect to receive a benefit from the asset.

Identifiable intangible assets are recorded at cost less accumulated amortisation and any provision for impairment. Intangible assets are tested for impairment only if there is some indication that the carrying value of the assets may have been impaired.

Impairments of assets are calculated as the difference between the carrying value of the asset and the recoverable amount, if lower. Where such an asset does not generate cash flows that are independent from other assets, the recoverable amount of the cash-generating unit to which that asset belongs is estimated. Impairments are recognised in the income statement and are disclosed separately. Any assets which suffered impairment in a previous period are reviewed for possible reversal of the impairment at each reporting date.

Internally generated intangible assets, such as software, are recognised only if: an asset is created that can be identified; it is probable that the asset created will generate future economic benefits; and that the development cost of the asset can be measured reliably. Where no internally generated intangible asset can be recognised, development expenditure is recorded as an expense in the period in which it is incurred.

Intangible assets under development are not amortised. Other non-current intangible assets are amortised on a straight-line basis over their estimated useful economic lives. The amortisation period for software is usually between three to seven years but can be up to ten years.

	Software £m
Cost at 31 March 2019	
Acquisition of business	187
Additions	53
Reclassifications	(2)
Cost at 31 March 2020	238
Additions	54
Disposals	(15)
Reclassifications ¹	23
Cost at 31 March 2021	300
Accumulated amortisation at 31 March 2020	(30)
Amortisation charge for the year	(35)
Disposals	15
Accumulated amortisation at 31 March 2021	(50)
Net book value at 31 March 2021	250
Net book value at 31 March 2020	208

¹ Reclassification represents amounts transferred (to)/from property, plant and equipment (see note 8).

8. Property, plant and equipment

The following note shows the physical assets controlled by us. The cost of these assets primarily represents the amount initially paid for them. This includes both their purchase price and the construction and other costs associated with getting them ready for operation. A depreciation expense is charged to the income statement to reflect annual wear and tear and the reduced value of the asset over time. Depreciation is calculated by estimating the number of years we expect the asset to be used (useful economic life) and charging the cost of the asset to the income statement equally over this period.

Property, plant and equipment is recorded at cost, less accumulated depreciation and any impairment losses.

Cost includes the purchase price of the asset, any payroll and finance costs incurred which are directly attributable to the construction of property, plant and equipment as well as the cost of any associated asset retirement obligations.

Property, plant and equipment includes assets in which the ESO's interest comprises legally protected statutory or contractual rights of use. Additions represent the purchase or construction of new assets, including capital expenditure for safety and environmental assets, and extensions to, enhancements to, or replacement of existing assets. All costs associated with projects or activities which have not been fully commissioned at the period end are classified within assets in the course of construction.

No depreciation is provided on freehold land or assets in the course of construction.

Other items of property, plant and equipment are depreciated, on a straight-line basis, at rates estimated to write off their book values over their estimated useful economic lives. In assessing estimated useful economic lives, consideration is given to any contractual arrangements and operational requirements relating to particular assets. The assessments of estimated useful economic lives and residual values of assets are performed annually.

With effect from 1 April 2019, new lease arrangements entered into are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the company. The right-of-use asset and associated lease liability arising from a lease are initially measured at the present value of the lease payments expected over the lease term. The discount rate applied is the rate implicit in the lease or if that is not available, then the incremental rate of borrowing for a similar term. The lease term takes account of exercising any extension options that are at our option if we are reasonably certain to exercise the option and any lease termination options unless we are reasonably certain not to exercise the option. The lease term does not include any lease extension options at the option of the lessor but does include lease termination options unless we are reasonably certain that the lessor will not exercise them. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to the income statement over the lease period using the effective interest rate method. The right-of-use asset is depreciated over the

shorter of the asset's useful life and the lease term on a straight-line basis. For short-term leases (lease term of 12 months or less) and leases of low value assets (such as computers), the Group continues to recognise a lease expense on a straight-line basis.

Unless otherwise determined by operational requirements, the depreciation periods for the principal categories of property, plant and equipment are, in general, as shown in the table below:

	Years
Freehold and Leasehold buildings	10 to 50
Motor vehicles	5 to 7
Office equipment	3 to 10

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within operating profit in the income statement.

Items within property, plant and equipment are tested for impairment only if there is some indication that the carrying value of the assets may have been impaired.

Impairments of assets are calculated as the difference between the carrying value of the asset and the recoverable amount, if lower. Where such an asset does not generate cash flows that are independent from other assets, the recoverable amount of the cash-generating unit to which that asset belongs is estimated.

Impairments are recognised in the income statement and if immaterial are included within depreciation charge for the year.

Any assets which suffered impairment in a previous period are reviewed for possible reversal of the impairment at each reporting date.

	Land and buildings £m	Plant and machinery £m	Assets in the course of construction £m	Motor vehicles and office equipment £m	Total £m
Cost at 31 March 2019	—	—	—	—	—
Acquisition of business	29	1	56	9	95
Additions	2	—	30	7	39
Reclassifications	—	16	(14)	—	2
Cost at 31 March 2020	31	17	72	16	136
Additions	2	6	27	—	35
Disposals	—	—	1	—	1
Reclassifications ¹	—	6	(55)	26	(23)
Cost at 31 March 2021	33	29	45	42	149
Accumulated depreciation at 31 March 2020	(5)	—	—	(3)	(8)
Depreciation charge for the year	(4)	—	—	(6)	(10)
Impairment	—	—	(3)	—	(3)
Accumulated depreciation at 31 March 2021	(9)	—	(3)	(9)	(21)
Net book value at 31 March 2021	24	29	42	33	128
Net book value at 31 March 2020	26	17	72	13	128

¹ Included within reclassifications are assets transferred from Intangibles (see Note 8) to the value of £2m.

Right-of-use assets are included within the net book value of property, plant and equipment at 31 March 2021. The total net book value of these assets as at 31 March 2021 was £32,000 (2020: £44,000) in respect of the motor vehicles and office equipment category.

9. Other non-current assets

Other non-current assets include income which will not be collected until after 31 March 2021. Non-current assets are initially recognised at fair value and subsequently measured at amortised cost. There is no material difference between the fair value and the carrying value of other non-current assets.

	2021 £m	2020 £m
Other assets ¹	109	—
	109	—

¹ Includes £109m relating to TNUoS charges caused by timing difference between amounts charged to customers and that passed through to the GB Transmission Owners, this includes regulatory term 'K'. Prior year balance was nil due to an over collection of revenue in 2020, which resulted in the timing difference being recorded as a non-current liability.

10. Financial assets and other investments

The financial assets and other Investments balance of £204m comprises current loans to the ultimate parent company and restricted cash balances in relation to Network Innovation Competition (NIC) projects.

Debt instruments that have contractual cash flows that are solely payments of principal and interest, and which are held within a business model whose objective is to collect contractual cash flows, are held at amortised cost.

They are initially recognised on trade date at fair value less transaction costs and expected losses. In the current year, the transaction value equals fair value.

Interest income is recognised using the effective interest method. Interest income, together with gains and losses when the loans and receivables are derecognised or impaired, is recognised in the income statement.

	2021 £m	2020 £m
Current		
Restricted cash	18	18
Loans and receivables	186	346
	204	364
Financial assets and other investments comprise the following:		
NIC restricted cash deposits	18	18
Loans and receivables - amount due from the ultimate parent company	186	346
	204	364

The carrying value of current financial assets at amortised cost approximates their fair values, primarily due to short-dated maturities. The exposure to credit risk at the reporting date is the fair value of the financial investments.

11. Trade and other receivables

Trade and other receivables are amounts which are due from our customers for services we have provided.

Trade and other receivables are initially recognised at fair value and subsequently measured at amortised cost, less any appropriate allowances for estimated irrecoverable amounts.

Trade receivables are non-interest-bearing and generally have a 30 day term. Due to their short maturities, the fair value of trade and other receivables approximates their book value. All other receivables are recorded at amortised cost. The provision for impairment of receivables as at 31 March 2021 was £17m (2020: £31m).

	2021 £m	2020 £m
Current		
Trade receivables	106	68
Amounts owed by ultimate parent	1	—
Accrued income	361	253
Prepayments	1	2
Other receivables	62	44
	531	367

Provision for impairment of receivables

A provision matrix is not used to assess expected loss rates as an assessment is performed on individual debtors.

In determining the provision for bad and doubtful debts as at 31 March 2021, we have considered the evolving financial impact of the restrictions put in place as a result of Covid-19 on our ability to collect amounts. After consideration, there were no adjustments made.

	2021 £m	2020 £m
At 1 April	31	—
Acquisition of business	—	30
Charge/(write-off) for the year ¹	(15)	2
Amounts recovered in the year	1	(1)
At 31 March	17	31

12. Cash and cash equivalents

Cash and cash equivalents include cash balances, together with short-term investments with an original maturity of less than three months that are readily convertible to cash.

Net cash and cash equivalents reflected in the cash flow statement are net of bank overdrafts, which are reported in borrowings. The carrying amounts of cash and cash equivalents and bank overdrafts approximate their fair values.

Cash at bank earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for periods varying between one day and three months, depending on the immediate cash requirements, and earn interest at the respective short-term deposit rates.

Net cash and cash equivalents held in currencies other than sterling have been converted into sterling at year-end exchange rates.

	2021 £m	2020 £m
Cash at bank and short-term deposits	12	1

13. Borrowings

We borrow money primarily in the form of borrowings from our ultimate parent company. These are for a fixed term and have floating interest rates.

Our price controls and rate plans lead to an optimal ratio of debt to equity and, as a result, we have issued debt to maintain this balance.

Borrowings are initially recorded at fair value this normally reflects the proceeds received (net of direct issue costs for liabilities measured at amortised cost). Subsequently these are stated at amortised cost. Any difference between the proceeds after direct issue costs and the redemption value is recognised over the term of the borrowing in the income statement using the effective interest method.

Information on our net debt is presented in note 19.

	2021 £m	2020 £m
Current		
Borrowings from the ultimate parent company	120	121
Total borrowings	120	121

Total borrowings are repayable as follows:

At 31 March 2021, we had committed external credit facilities of £550m of which £550m was undrawn (2020: £550m of which £550m undrawn). We also have £550m of intercompany credit facilities with our ultimate parent, National Grid plc of which £550m was undrawn (2020: £550m of which £550m undrawn). All of the unused facilities at 31 March 2021 are available for liquidity purposes.

None of the ESO's borrowings are secured by charges over assets of the Company.

Lease liabilities

Lease liabilities are initially measured at the present value of the lease payments expected over the lease term. The discount rate applied is the rate implicit in the lease or if that is not available, then the incremental rate of borrowing for a similar term. The lease term takes account of exercising any extension options that are at our option if we are reasonably certain to exercise the option and any lease termination options unless we are reasonably certain not to exercise the option. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to the income statement over the lease period using the effective interest rate method.

Right-of-use assets were included within property, plant and equipment (see note 8) at 31 March 2021 with outstanding leases to the value of £130,000 (2020: £144,000) relating to motor vehicles.

14. Trade and other payables

Trade and other payables include amounts owed to suppliers, tax authorities and other parties which are due to be settled within 12 months. The total also includes deferred amounts, some of which represents monies received from customers but for which we have not yet delivered the associated service. These amounts are recognised as revenue when the service is provided.

Trade payables are initially recognised at fair value and subsequently measured at amortised cost.

	2021 £m	2020 £m
Trade payables	288	174
Social security and other taxes ¹	133	161
Deferred income ²	180	128
Amounts owed to fellow subsidiaries of National Grid plc	38	22
Other payables	98	49
	737	534

Due to their short maturities, the fair value of trade payables approximates their book value.

¹ Includes Value Added Tax of £132m (2020: £160m).

² Includes £61m relating to TNUoS charges caused by timing differences between amounts charged to customers and that passed through to the GB Transmission Owners, this includes regulatory term 'K'.

15. Other non-current liabilities

Other non-current liabilities include deferred income which will not be recognised as income until after 31 March 2022.

Non-current liabilities are initially recognised at fair value and subsequently measured at amortised cost. There is no material difference between the fair value and the carrying value of other payables.

	2021 £m	2020 £m
Deferred income ¹	2	73
Other payables ²	25	17
	27	90

¹ £1.7m Interconnector revenue adjustment for TNUoS tariff forecast.

² Balances held in relation to application fees collected on behalf of GB Transmission Owners.

16. Provisions

We make provisions when an obligation exists, resulting from a past event and it is probable that cash will be paid to settle it, but the exact amount of cash required can only be estimated.

The main estimates relate to provisions for restructuring plans. The evaluation of the likelihood of the contingent events has required best judgement by management regarding the probability of exposure to potential loss. Should circumstances change following unforeseeable developments, the likelihood could alter.

Provisions are recognised where a legal or constructive obligation exists at the reporting date, as a result of a past event, where the amount of the obligation can be reliably estimated and where the outflow of economic benefit is probable.

Changes in the provision arising from revised estimates or discount rates or changes in the expected timing of expenditures are recognised in the income statement.

	Restructuring £m	
At 1 April 2019		–
Acquisition of business		18
Utilised		(6)
At 31 March 2020		12
Additions		–
Utilised		(10)
At 31 March 2021		2

	2021 £m	2020 £m
Current	2	11
Non-current	–	1
	2	12

Restructuring provision

The provision and obligation associated with the restructuring were acquired by the business on 1st April 2019. This resulted in recognition of an £18m provision. A cost efficiency and restructuring programme has continued throughout 2020 and 2021 and the majority of this provision has been utilised, with a balance of £2m remaining as at 31 March 2021. We expect the remaining provision to be utilised within one year.

17. Share capital and share premium

Ordinary share capital represents the total number of shares issued.

Share capital is accounted for as an equity instrument. An equity instrument is any contract that includes a residual interest in the consolidated assets of the Company after deducting all its liabilities and is recorded as the proceeds received, net of direct issue costs, with an amount equal to the nominal amount of the shares issued included in the share capital account and the balance recorded in the share premium account.

	Number of shares 2021 millions	Number of shares 2020 millions	2021 £m	2020 £m
At 31 March 2020 and 2021				
- ordinary shares of 1p each				
Allotted, called-up and fully paid	330	330	3	3
	Number of shares millions	Par value £m	Share premium £m	Total £m
At 31 March 2020	330	3	327	330
Equity arising on issue of ordinary shares				
At 31 March 2021	330	3	327	330

18. Other equity - merger reserve

Other equity reserves are different categories of equity as required by accounting standards and represent the impact of a number of our historical transactions.

At 31 March 2021, the ESO held one form of other equity, being a merger reserve. The merger reserve arose on the acquisition of the ESO business on 1 April 2019. This acquisition did not fall within the scope of IFRS 3 Business Combinations, thus, assets and liabilities were transferred at their net book value. The difference between the net book value and consideration paid for the assets and liabilities acquired resides within this reserve.

As the amounts included in other equity reserves are not attributable to any of the other classes of equity presented, they have been disclosed as a separate classification of equity.

	Merger reserve £m
At 31 March 2020 & 31 March 2021	(142)

The merger reserve is principally attributable to the ESO business's exclusive licence and profitability.

Merger reserve balance remains at £142m at 31 March 2021, £55m is considered realised for the purposes of assessing the company's distributable profits and £87m is considered unrealised. Accordingly, at 31 March 2021 the profits available for distribution by the company were £87m, comprising the whole of the company's retained earnings less the realised element of the merger reserve.

19. Net debt

Net debt represents the amount of borrowings and overdrafts less cash, current financial investments and related financing derivatives.

Funding and liquidity risk management is carried out by the National Grid plc treasury function under policies and guidelines approved by the Finance Committee of the National Grid plc Board, these policies have been deemed applicable at the ESO by their respective board of directors. The Finance Committee is responsible for the regular review and monitoring of treasury activity and for the approval of specific transactions, the authority for which fall outside the delegation of authority to management.

The ESO apply the National Grid plc group policy and we utilise the group treasury function. The primary objective of the treasury function is to manage our funding and liquidity requirements. A further important objective is to manage the associated financial risks, in the form of interest rate risk and foreign exchange risk, to within pre-authorised parameters. Further details can be found in the National Grid plc accounts available publicly, details on how to access can be found in Note 22.

Investment of surplus funds, usually in short-term fixed deposits or placements with money market funds that invest in highly liquid instruments of high credit quality, is subject to our counterparty risk management policy.

(a) Reconciliation of net cash flow to movement in net debt

	2021 £m	2020 £m
Increase in cash and cash equivalents ¹	11	1
Increase/(Decrease) in financial investments	(160)	364
Increase in borrowings and related derivatives	—	(120)
Net interest receivable/(payable) on the components of net debt	1	(1)
Change in net debt resulting from cash flows	(148)	244
Movement in net debt in the year	(148)	244
Net debt at the start of the year	244	—
Net debt at the end of the year	96	244
Composition of net debt		
Net debt as follows:		
	2021 £m	2020 £m
Cash, cash equivalents and financial investments	216	365
Borrowings and bank overdrafts	(120)	(121)
	96	244

¹ 2020 includes £13m of cash acquired as part of the ESO business on 1 April 2019.

(b) Analysis of changes in net debt

	Cash and cash equivalents £m	Financial investments £m	Borrowings £m	Total debt £m
At 1 April 2019	—	—	—	—
Cash flow	1	364	(120)	245
Fair value gains and losses and exchange movements	—	—	—	—
Interest income/(charges)	—	—	(1)	(1)
At 31 March 2020	1	364	(121)	244
Cash flow	11	(160)	1	(148)
At 31 March 2021	12	204	(120)	96
Balances at 31 March 2020 comprise:				
Current assets	12	204	—	216
Current liabilities	—	—	(120)	(120)
	12	204	(120)	96

20. Commitments and contingencies

Commitments are those amounts that we are contractually required to pay in the future as long as the other party meets its obligations. These commitments primarily relate to contract for the purchase of assets which, in many cases, extend over a long period of time. We also disclose any contingencies, which include guarantees that companies have given, where we pledge assets against current obligations that will remain for a specific period.

Future capital expenditure	2021 £m	2020 £m
Contracted for but not provided	25	25
Balances as at 31 March 2021 comprise:		
Amounts due: Less than 1 year	24	20
More than 1 year	1	5
	25	25

Pension Scheme Contributions

The ESO is a participating employer in the National Grid ESPS defined benefit pension scheme. Following completion of the March 2019 valuation, we are responsible for making contributions into the scheme equivalent to 44% (average) of remaining active employees pensionable salaries.

In 2020/21, we also contributed an additional amount into the scheme relating to the funding deficit to the value of £12m. This additional payment is made in line with the regulatory treatment determined by Ofgem. The most recently agreed recovery plan for the scheme runs until FY24. As the ESO is not the sponsoring employer of the scheme, there is no contractual obligation or requirement to make a provision for scheme costs.

Ofgem investigation

On 15 May 2018, Ofgem opened an investigation into the Company (when it still formed part of National Grid Electricity Transmission Plc) pertaining to an alleged breach of its licence condition to operate the system in an economic and efficient manner, including the production and publication of forecasts of demand on the electricity transmission network.

A settlement of £1.5m (which has been fully provided for in 2020/21) has since been agreed with Ofgem and the investigation is now closed. The ESO acknowledge Ofgem's decision and fully cooperated with its investigation.

As part of our settlement, we acknowledge that for five months during 2017, we produced inaccurate demand forecasts due to immaturity in the process at the time. Since then, we have invested significantly in our demand forecasting capability, improving the tools and processes involved and trialling innovative new approaches. This has driven a significant improvement in our forecasting.

Ofgem's investigation has confirmed that there are no issues with our current electricity demand forecasting and that the issue under investigation was fully resolved by December 2017.

21. Related party transactions

A related party is a company or individual who also has an interest in us, for example a company that provides a service to us with a director who holds a controlling stake in that company and who is also a Director of National Grid Electricity System Operator Limited. The related parties identified include fellow subsidiaries, joint ventures, associated undertakings, investments and key management personnel.

The following significant transactions with related parties were in the normal course of business. Amounts receivable from and payable to related parties are due on normal commercial terms:

	2021 £m	2020 £m
Income		
Goods and services supplied	1	1
	1	1
Expenditure:		
Services received ¹	(1,879)	(1,900)
Balance Sheet as at 31 March:		
Lending to ultimate parent (amounts due within one year)	186	346
Borrowings from ultimate parent (amounts due within one year)	(120)	(121)
Amounts payable at 31 March	(38)	(22)

¹ Balances of expenditure relate to TNUoS revenue collection, for National Grid Electricity Transmission plc, additional information can be found in Note 2.

Amounts receivable from or payable to related parties in respect of income and expenditure are ordinarily settled one month in arrears. Advances to and borrowings from fellow subsidiary undertakings are repayable on demand and bear interest at commercial rates.

Expenditure balances relate to the collection of TNUoS revenues on behalf of National Grid Electricity Transmission plc. Under IFRS 15 we act as an agent and these balances are shown net within our revenue figure. Further details of this relationship have been provided in Note 2.

Information relating to pension fund arrangements is disclosed in note 20.

22. Ultimate parent company

This note shows the immediate and ultimate parent companies for these consolidated financial statements.

National Grid Electricity System Operator Limited's immediate parent company is National Grid Holdings One plc. The ultimate parent company, and controlling party, is National Grid plc. Both companies are incorporated in Great Britain and are registered in England and Wales. National Grid plc consolidates the financial statements of National Grid Electricity System Operator Limited.

Copies of the consolidated financial statements of National Grid plc may be obtained from the Company Secretary, 1-3 Strand, London WC2N 5EH, or on our company website. <http://investors.nationalgrid.com>

23. Subsidiaries and associates

The ESO holds investments in subsidiaries and associates, the company includes contributions from associates which are detailed in the below table.

Subsidiary undertakings

The list below contains all subsidiaries held by National Grid Electricity System Operator Limited.

	Principal activity	Holding
Elexon Limited ¹ 4th Floor 350 Euston Road, London NW1 3AW	Electricity market Balancing and Settlement Code company for Great Britain	100%

¹ National Grid Electricity System Operator does not consolidate its wholly owned subsidiary Elexon Limited, as it does not control the entity.

All subsidiaries are incorporated in England and Wales.

The Elexon Limited shares were inherited on 1 April 2019 as part of the purchase of the ESO business from NGET plc.

Associates

The list below contains all associates included within the National Grid Electricity System Operator Limited.

	Principal activity	Holding
Coreso SA (incorporated in Belgium) 71 Avenue de Cortnbergh, 1000 Bruxelles, Belgium	Associate in relation to a European regional transmission operations coordination centre	16%

The Coreso SA shares were inherited on 3 May 2019 as part of the purchase of the ESO business from NGET plc.

References to the ‘Company’, ‘we’, ‘our’ and ‘us’ refer to National Grid Electricity System Operator Limited itself.

Carbon intensity

The measure of CO₂ emissions produced per kilowatt hour of electricity consumed.

EMR Delivery Body

Provides independent evidence and analysis to the UK Government to inform its decisions on the key rules and parameters to achieve the Government’s policy objectives under EMR, administers key elements of the capacity mechanism and contracts for difference regime and reports to the Government annually on performance against the Government’s delivery plan.

Electricity Market Reform (EMR)

A government policy to incentivise delivery of low carbon energy supplies whilst maintaining security of supply and minimising the cost to the consumer.

EU

European Union.

FRS

Financial Reporting Standard.

GAAP

Generally Accepted Accounting Principles.

GHG

Greenhouse gas.

GW

Gigawatt, 109 watts.

GWh

Gigawatt hours.

HSE

Health and Safety Executive.

IAS

International Accounting Standard.

IASB

International Accounting Standards Board.

IFRIC

The International Financial Reporting Interpretations Committee, which provides guidance on how to apply accounting standards.

IRFS

International Financial Reporting Standard.

KPI

Key Performance Indicator.

Lost time injury

A work-related injury which causes a person to be away from work for at least one normal shift after the shift on which the injury occurs, because the person is unfit to perform his or her duties.

National Grid

National Grid plc, the ultimate parent company of National Grid Electricity System Operator Limited and its controlling party.

Ofgem

The Office of Gas and Electricity Markets.

Regulatory asset value (RAV)

The value ascribed by Ofgem to the capital employed in the licensed business. It is an estimate of the initial market value of the regulated asset base at privatisation, plus subsequent allowed additions at historic costs, less the deduction of annual regulatory depreciation. Deductions are also made to reflect the value realised from the disposal of certain assets that formed part of the regulatory asset base. It is also indexed to the RPI to allow for effects to inflation.

Regulated controllable operating costs

Total operating costs under IFRS less depreciation and certain regulatory costs where, under our regulatory agreements, mechanisms are in place to recover such costs in current or future periods.

RIIO

The revised regulatory framework issued by Ofgem which was implemented in the eight-year price controls which started on 1 April 2013.

RoE

A performance metric measuring returns from the investment of shareholders’ funds. UK regulated return on equity is a measure of how a business is performing operationally against the assumptions used by Ofgem. These returns are calculated using the assumption that the businesses are financed in line with the regulatory adjudicated capital structure, at the assumed cost of debt and that UK taxation paid is at the level assumed by Ofgem.

RPI

UK Retail Price Index.

Tonnes CO₂ equivalent

Measure of greenhouse gas emissions in relation to the impact of carbon dioxide.

TW

Terawatt, 1012 watts.

TWh

Terawatt hours.

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