# Financial Statements

## Contents

# Introduction to the financial statements

We have continued to develop our presentational format to provide shareholders and users of these financial statements with additional information and guidance, and to make them easier to understand.

Throughout these financial statements we have included additional information boxes, providing helpful commentary on what the disclosures mean and why they are important to the understanding of our financial performance and position. Some of these boxes highlight 'Our strategy in action', drawing out the key elements of our business model (set out in the Strategic Report on pages 14 and 21), and showing how the disclosures reflect this strategy.

## Audit opinions

We have two audit opinions on our financial statements, reflecting our dual listing on the London Stock Exchange and the New York Stock Exchange. Due to the different reporting requirements for each listing, our auditors are required to confirm compliance with each set of standards in a prescribed format. The IFRS audit opinion has changed this year, reflecting the change to auditing standards, which requires the auditors to provide more detail as to how they have planned and completed their audit, as well as their views on significant matters they have noted and that were discussed by the Audit Committee. There are also additional specific disclosure requirements due to our US listing which are included in the notes.

## 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.

## Unaudited commentary

We have presented with the financial statements certain analysis previously included in the financial review section of the Strategic Report of our Annual Report. This approach provides a more understandable narrative, a logical flow of information and reduces duplication. We have created a combined financial review, including a commentary on items within the primary statements, on pages 84 to 91. Unless otherwise indicated, all analysis provided in the financial statements is on a statutory IFRS basis. All information in ruled boxes styled in the same manner as this one does not form part of the audited financial statements. This has been further highlighted by including the word 'unaudited' at the start of each box header. Unaudited commentary boxes appear on pages 85 to 87, 89, 91, 96, 106, 108 and 121.

# Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and Accounts, including the consolidated financial statements and the Company financial statements, the Directors' Report, including the Remuneration Report and the Strategic Report, in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, and the Company financial statements and the Remuneration Report in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom generally accepted accounting practice, UK GAAP). In preparing the consolidated financial statements, the Directors have also elected to comply with IFRS, issued by the International Accounting Standards Board (IASB). 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 on a consolidated and individual basis and of the profit or loss of the Company on a consolidated basis for that period.

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state that the consolidated financial statements comply with IFRS as issued by the IASB and IFRS adopted by the EU and, with regard to the Company financial statements, that applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the consolidated financial statements and Company financial statements on a going concern basis unless it is inappropriate to presume that the Company, on a consolidated and individual basis, will continue in business, in which case there should be supporting assumptions or qualifications as necessary.

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 on a consolidated and individual basis, and to enable them to ensure that the consolidated financial statements comply with the Companies Act 2006 and Article 4 of the IAS Regulation and the Company financial statements and the Remuneration Report comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and its subsidiaries 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 Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors, whose names and functions are listed on page 43, confirms that:

- to the best of their knowledge, the consolidated financial statements and the Company financial statements, which have been prepared in accordance with IFRS as issued by the IASB and IFRS as adopted by the EU and UK GAAP respectively, give a true and fair view of the assets, liabilities, financial position and profit of the Company on a consolidated and individual basis;
- to the best of their knowledge, the Strategic Report contained in the Annual Report and Accounts includes a fair review of the development and performance of the business and the position of the Company on a consolidated and individual basis, together with a description of the principal risks and uncertainties that it faces; and
- they consider that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

By order of the Board

**Alison Kay**
Group General Counsel & Company Secretary
18 May 2014
Company number: 4031152

# Independent auditors' report

to the Members of National Grid plc

## Report on the financial statements

### Our opinion

In our opinion:

- the financial statements, defined below, give a true and fair view of the state of the Group's and of the Company's affairs as at 31 March 2014 and of the Group's profit and cash flows for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) adopted by the EU;
- the Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP); and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

This opinion is to be read in the context of what we say in the remainder of this report.

### Separate opinion in relation to IFRSs as issued by the IASB

As explained in the Basis of preparation to the financial statements, the Group, in addition to applying IFRSs as adopted by the EU, has also applied IFRSs as issued by the IASB.

In our opinion the Group financial statements comply with IFRSs as issued by the IASB.

### What we have audited

The Group financial statements and Company financial statements (the financial statements), which are prepared by National Grid plc, comprise:

- the Consolidated income statement and Consolidated statement of comprehensive income for the year then ended;
- the Consolidated statement of changes in equity for the year then ended;
- the Consolidated statement of financial position and Company balance sheet as at 31 March 2014;
- the Consolidated statement of cash flows for the year then ended;
- the Consolidated and Company Basis of preparation; and
- the notes to the Consolidated financial statements and the notes to the Company financial statements, which include explanatory and supplementary information.

We have not audited the Unaudited commentary that is included with the financial statements.

The financial reporting framework that has been applied in the preparation of the Group financial statements comprises applicable law and IFRSs as adopted by the EU. The financial reporting framework that has been applied in the preparation of the Company financial statements comprises applicable law and UK GAAP.

Certain disclosures, including Directors' Remuneration, required by the financial reporting framework have been presented elsewhere in the Annual Report and Accounts (the Annual Report), rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

### What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's and Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### Overview of our audit approach

#### Materiality

We consider an item material if, in our judgement, it is likely to have an impact on the economic decisions of the Company members to whom this opinion is addressed.

We set certain thresholds for materiality. These helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of potential misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the Group financial statements as a whole (overall materiality) to be £126m which represents approximately 5% of profit before tax, exceptional items, remeasurements and stranded cost recoveries, which we have determined to be the relevant measure of underlying business performance.

We reported all misstatements greater than £6m identified by our audit to the Audit Committee.

#### Overview of the scope of our audit

The Group is structured along four business segments being UK Electricity Transmission, UK Gas Transmission, UK Gas Distribution and US Regulated with activities falling outside these business segments included in Other activities.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed at the reporting units, within these business segments, by us, as the Group engagement team, or component auditors within PwC UK and from other PwC network firms operating under our instruction. Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those business segments to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole.

Accordingly, we identified that UK Electricity Transmission, UK Gas Transmission, UK Gas Distribution and US Regulated required an audit of their complete financial information due to their size.

# Independent auditors' report

## to the Members of National Grid plc continued

Specific audit procedures on certain balances and transactions were also performed at four reporting units within Other activities. The procedures described above provide coverage of 86% of profit before tax before exceptional items, remeasurements and stranded cost recoveries. In addition, we performed specific procedures on exceptional items, remeasurements and stranded cost recoveries. This, together with the procedures performed at the Group level, gave us the evidence we needed for our opinion on the Group financial statements as a whole. The Group team retains overall responsibility for the audit of the financial statements.

### Areas of audit focus

In preparing the financial statements, the directors made a number of subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We primarily focused our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

In our audit, we tested and examined information, using sampling and other auditing techniques, to the extent we considered necessary to provide a reasonable basis for us to draw conclusions. We obtained audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

We considered the following to be areas that required particular focus in the current year. This is not a complete list of all risks or areas of focus identified by our audit. We discussed these areas of focus with the Audit Committee. Their report on those matters that they considered to be significant issues in relation to the financial statements is set out on page 49.

The risks underlying the areas of focus can be categorised by their principal nature.

| | Principal nature of risk | |
|---|---|---|
| Area of focus | Fraud | Error |
| **Recurring risks** | | |
| Presentation of exceptional items and quality of earnings | • | • |
| Management override of internal controls | • | |
| Accuracy and valuation of treasury derivative transactions | | • |
| **Event-driven risks** | | |
| Impact of the US enterprise resource system stabilisation on financial close process | | • |
| LIPA contract accounting | | • |

We set out below further details of each of the areas of focus along with how they were addressed by the scope of our audit.

Area of focus:
**Presentation of exceptional items and quality of earnings**
The directors' assessment of what is exceptional is judgemental and while National Grid has a policy, by its nature there is judgement included in applying this and deciding which items to include and exclude.

How the scope of our audit addressed the area of focus:
We have tested the existence and completeness of amounts recorded as exceptional items and assessed management's judgements that they are aligned to the underlying policy disclosed on page 99.

Area of focus:
**Accuracy and valuation of treasury derivative transactions**
National Grid has a significant treasury position with total borrowings as detailed in note 19. The valuation of derivatives is a complex and judgemental area and the strategies used by the directors for hedge accounting are varied.

How the scope of our audit addressed the area of focus:
We tested the controls surrounding the treasury management systems and the data entry into these systems. We confirmed with external counterparties the accuracy of the derivative transactions recorded.

We obtained evidence to support the directors' strategies and key inputs into the models, in particular price assumptions and agreed key contractual inputs back to underlying sources. We also tested the integrity of the valuation model, including the formulae applied in the model.

Area of focus:
**Management override of internal controls**
ISAs (UK & Ireland) require that we consider this.

How the scope of our audit addressed the area of focus:
We tested the appropriateness of manual journal entries. We considered whether there was evidence of bias by the directors in the significant accounting estimates and judgements relevant to the financial statements. We also assessed the overall control environment of the Group, including the arrangements for employees to 'whistle-blow' inappropriate actions, and interviewed senior management and the Group's internal audit function in respect of fraud.

Area of focus:
Impact of the US enterprise resource system stabilisation on financial close process
The continued implementation programme associated with the new US enterprise resource system in National Grid US has resulted in ongoing changes to key business processes and controls. These changes and the introduction of a number of temporary manual controls mean the financial information of National Grid US is subject to a higher risk of error, in particular in relation to potential issues with user access controls, the quality of account reconciliations and the capitalisation of labour and contractor costs into property, plant and equipment (PPE).

How the scope of our audit addressed the area of focus:
We tested the design and operating effectiveness of key IT controls relating to segregation of duties and user access, including monitoring controls, to confirm appropriate use of system access.

We identified the critical reconciliations in place to support the Group financial statements and tested that these reconciliations were performed and reviewed, and that reconciling items were appropriately supported.

We tested the design and operating effectiveness of key controls in relation to the capitalisation of internal labour costs within PPE. We also tested costs incurred and the treatment of these costs as capitalised or expensed.

Area of focus:
LIPA contract accounting
National Grid US's 15 year PSA with LIPA was renewed in May 2013. This is a complex agreement and required significant judgement by the directors in respect of its accounting treatment under leasing accounting standards.

During the year National Grid US transitioned the operation of another significant contract, the LIPA Management Services Agreement (MSA), to a new contractor. This process was complex and involved the transition of a significant number of employees, and related accounting judgements. LIPA MSA transition costs have been treated by the directors as exceptional as set out on page 99, which was considered as part of the presentation of exceptional items and quality of earnings area of focus.

How the scope of our audit addressed the area of focus:
For both the PSA and MSA contracts we considered the implications of the specific terms and conditions on the recognition and measurement of liabilities. In relation to the PSA we considered management's judgements concerning the determination as to whether it should be recognised as an operating or finance lease based on the specific contractual terms and the requirements of IAS 17 'Leases'.

### Going concern
Under the Listing Rules we are required to review the directors' statement, set out on page 52, in relation to going concern. We have nothing to report having performed our review.

As noted in the directors' statement, the directors have concluded that it is appropriate to prepare the Group's and Company's financial statements using the going concern basis of accounting. The going concern basis presumes that the Group and Company have adequate resources to remain in operation, and that the directors intend them to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's and the Company's ability to continue as a going concern.

## Opinions on other matters prescribed by the Companies Act 2006
In our opinion:

- 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;
- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Strategic Report set out on pages 22 to 25 in the Annual Report with respect to internal control and risk management systems and about share capital structures on pages 174 and 175 are consistent with the financial statements.

## Other matters on which we are required to report by exception
### Adequacy of accounting records and information and explanations received
Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

# Independent auditors' report

to the Members of National Grid plc continued

## Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law have not been made. We have no exceptions to report arising from this responsibility.

## Corporate Governance statement

Under the Companies Act 2006, we are required to report to you if, in our opinion, a corporate governance statement has not been prepared by the Company. We have no exceptions to report arising from this responsibility.

Under the Listing Rules we are required to review the part of the Corporate Governance statement relating to the Company's compliance with nine provisions of the UK Corporate Governance Code (the Code). We have nothing to report having performed our review.

On page 76 of the Annual Report, as required by the Code Provision C.1.1, the directors state that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's performance, business model and strategy. On page 50, as required by C3.8 of the Code, the Audit Committee has set out the significant issues that it considered in relation to the financial statements, and how they were addressed. Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

- the statement given by the directors is materially inconsistent with our knowledge of the Group acquired in the course of performing our audit; or
- the section of the Annual Report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have no exceptions to report arising from this responsibility.

## Other information in the Annual Report

Under ISAs (UK & Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group and Company acquired in the course of performing our audit; or
- is otherwise misleading.

We have no exceptions to report arising from this responsibility.

## Responsibilities for the financial statements and the audit

### Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 76, the directors are responsible for the preparation of the Group and Company financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the Group and Company financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

**Nicholas Blackwood (Senior Statutory Auditor)**
**for and on behalf of PricewaterhouseCoopers LLP**
Chartered Accountants and Statutory Auditors
London
21 May 2014

# Report of Independent Registered Public Accounting Firm

## to the Board of Directors and Shareholders of National Grid plc

### Audit opinion for Form 20-F

In our opinion, the accompanying consolidated statements of financial position and the related consolidated income statements, consolidated statements of comprehensive income, consolidated cash flow statements and consolidated statements of changes in equity, present fairly, in all material respects, the financial position of National Grid plc and its subsidiaries at 31 March 2014 and 31 March 2013, and the results of their operations and their cash flows for each of the three years in the period ended 31 March 2014 in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board and in conformity with International Financial Reporting Standards as adopted by the European Union.

Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of 31 March 2014, based on criteria established in Internal Control – Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the Additional Information section appearing on page 170 of the 2014 Annual Report and Accounts. As discussed in note 1, the Group changed the manner in which it accounts for employee benefits.

Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorisations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

**PricewaterhouseCoopers LLP**
London
United Kingdom
21 May 2014

# Basis of preparation

Accounting policies describe our approach to recognising and measuring transactions and balances in the year. Accounting policies applicable across the financial statements are shown below. 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 summarise new EU endorsed accounting standards, amendments and interpretations and whether these are effective in 2014 or later years, explaining how significant changes are expected to affect our reported results.

National Grid's principal activities involve the transmission and distribution of electricity and gas in Great Britain and northeastern US. The Company is a public limited liability company incorporated and domiciled in England, with its registered office at 1-3 Strand, London WC2N 5EH.

The Company has its primary listing on the London Stock Exchange and is also quoted on the New York Stock Exchange. These consolidated financial statements were approved for issue by the Board of Directors on 18 May 2014.

These consolidated financial statements have been prepared in accordance with International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) and related interpretations as issued by the International Accounting Standards Board (IASB) and IFRS as adopted by the EU. They are prepared on the basis of all IFRS accounting standards and interpretations that are mandatory for periods ending 31 March 2014 and in accordance with the Companies Act 2006 applicable to companies reporting under IFRS and Article 4 of the EU IAS Regulation. The 2013 and 2012 comparative financial information has also been prepared on this basis.

The consolidated financial statements have been prepared on an historical cost basis, except for the recording of pension assets and liabilities, the revaluation of derivative financial instruments and certain commodity contracts and investments classified as available-for-sale.

The consolidated financial statements have been prepared on a going concern basis following the assessment made by the Directors as set out on page 52.

These consolidated financial statements are presented in pounds sterling, which is also the functional currency of the Company.

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 (see accounting policy C).

## A. Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries, together with a share of the results, assets and liabilities of jointly controlled entities (joint ventures) and associates using the equity method of accounting, where the investment is carried at cost plus post-acquisition changes in the share of net assets of the joint venture or associate, less any provision for impairment.

A subsidiary is defined as an entity controlled by the Company. Control is achieved where the Company has the power to affect the returns of an entity to which it is exposed or to which it has rights.

Losses in excess of the consolidated interest in joint ventures and associates are not recognised, except where the Company or its subsidiaries have made a commitment to make good those losses.

Where necessary, adjustments are made to bring the accounting policies used in the individual financial statements of the Company, subsidiaries, joint ventures and associates into line with those used by the Company in its consolidated financial statements under IFRS. Intercompany transactions are eliminated.

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

Acquisitions are accounted for using the acquisition method, where the purchase price is allocated to the identifiable assets acquired and liabilities assumed on a fair value basis and the remainder recognised as goodwill.

## B. Foreign currencies

Transactions in currencies other than the functional currency of the Company or subsidiary concerned 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, except where the adoption of hedge accounting requires inclusion in other comprehensive income – note 15.

On consolidation, the assets and liabilities of operations that have a functional currency different from the Company's functional currency of pounds sterling, principally our US operations that have a functional currency of dollars, are translated at exchange rates prevailing at the reporting date. Income and expense items are translated at the weighted average exchange rates for the period where these do not differ materially from rates at the date of the transaction. Exchange differences arising are classified as equity and transferred to the consolidated translation reserve.

# Recent accounting developments

## C. Areas of judgement and key sources of estimation uncertainty

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.

Areas of judgement that have the most significant effect on the amounts recognised in the financial statements are as follows:

- the categorisation of certain items as exceptional items, remeasurements and stranded cost recoveries and the definition of adjusted earnings – notes 4 and 7; and
- energy purchase contracts classification as being for normal purchase, sale or usage – note 27.

IFRS 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, remeasurements and stranded cost recoveries. Exceptional items, remeasurements and stranded cost recoveries are presented separately on the face of the income statement.
- **Customer contributions:** contributions received prior to 1 July 2009 towards capital expenditure are recorded as deferred income and amortised in line with the depreciation on the associated asset.
- **Financial instruments:** we normally opt to apply hedge accounting in most circumstances where this is permitted. For net investment hedges, we have chosen to use the spot rate method, rather than the alternative forward rate method.

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:

- impairment of goodwill – note 9;
- review of residual lives, carrying values and impairment charges for other intangible assets and property, plant and equipment – notes 10 and 11;
- estimation of liabilities for pensions and other post-retirement benefits – notes 22 and 29;
- valuation of financial instruments and derivatives – notes 15 and 30;
- revenue recognition and assessment of unbilled revenue – note 2;
- recoverability of deferred tax assets – note 6; and
- environmental and decommissioning provisions – note 23.

In order to illustrate the impact that changes in assumptions could have on our results and financial position, we have included sensitivity analysis in note 33.

## New IFRS accounting standards and interpretations adopted in 2013/14

During the year ended 31 March 2014, with the exception of IAS 19 (revised), and in respect of disclosures required by IFRS 13 'Fair value measurements', the Company has not adopted any new IFRS, IAS or amendments issued by the IASB, or interpretations issued by the IFRS Interpretations Committee (IFRIC), which have had a material impact on the Company's consolidated financial statements. The impact of IAS 19 (revised) is set out in note 1. The additional disclosures required by IFRS 13 are included in note 30.

Other standards, interpretations and amendments issued by the IASB and IFRIC that have not had a material impact on the Company's consolidated results or assets and liabilities are:

- IFRS 10 'Consolidated financial statements';
- IFRS 11 'Joint arrangements';
- IFRS 12 'Disclosure of interests in other entities';
- amendments to IAS 27 'Separate financial statements' and IAS 28 'Investments in associates and joint ventures' as a result of the adoption of the above standards;
- amendments to IAS 1 'Presentation of financial statements'; and
- amendments to IFRS 7 'Financial instruments: Disclosures'.

## New IFRS accounting standards and interpretations not yet adopted

The Company enters into a significant number of transactions that fall within the scope of IFRS 9 'Financial instruments'. The IASB is completing IFRS 9 in phases and the Company is evaluating the impact of the standard as it develops. It is currently expected that the standard will be required to be adopted by the Company on 1 April 2018. We are currently assessing the likely impact of this standard on the Company's consolidated financial statements.

Other standards and interpretations or amendments thereto which have been issued, but are not yet effective, are not expected to have a material impact on the Company's consolidated financial statements.

# Consolidated income statement

## for the years ended 31 March

| | Notes | 2014 £m | 2014 £m | 2013 (restated)[1] £m | 2013 (restated)[1] £m | 2012 (restated)[1] £m | 2012 (restated)[1] £m |
|---|---|---|---|---|---|---|---|
| **Revenue** | 2(a) | | **14,809** | | 14,359 | | 13,832 |
| Operating costs | 3 | | **(11,074)** | | (10,610) | | (10,297) |
| **Operating profit** | | | | | | | |
| Before exceptional items, remeasurements and stranded cost recoveries | 2(b) | **3,664** | | 3,639 | | 3,491 | |
| Exceptional items, remeasurements and stranded cost recoveries | 4 | **71** | | 110 | | 44 | |
| **Total operating profit** | 2(b) | | **3,735** | | 3,749 | | 3,535 |
| **Finance income** | 5 | | **36** | | 30 | | 28 |
| **Finance costs** | | | | | | | |
| Before exceptional items and remeasurements | 5 | **(1,144)** | | (1,154) | | (1,118) | |
| Exceptional items and remeasurements | 4,5 | **93** | | 68 | | (70) | |
| **Total finance costs** | 5 | | **(1,051)** | | (1,086) | | (1,188) |
| Share of post-tax results of joint ventures and associates | 14 | | **28** | | 18 | | 7 |
| **Profit before tax** | | | | | | | |
| Before exceptional items, remeasurements and stranded cost recoveries | 2(b) | **2,584** | | 2,533 | | 2,408 | |
| Exceptional items, remeasurements and stranded cost recoveries | 4 | **164** | | 178 | | (26) | |
| **Total profit before tax** | 2(b) | | **2,748** | | 2,711 | | 2,382 |
| **Taxation** | | | | | | | |
| Before exceptional items, remeasurements and stranded cost recoveries | 6 | **(581)** | | (619) | | (697) | |
| Exceptional items, remeasurements and stranded cost recoveries | 4,6 | **297** | | 62 | | 234 | |
| **Total taxation** | 6 | | **(284)** | | (557) | | (463) |
| **Profit after tax** | | | | | | | |
| Before exceptional items, remeasurements and stranded cost recoveries | | **2,003** | | 1,914 | | 1,711 | |
| Exceptional items, remeasurements and stranded cost recoveries | 4 | **461** | | 240 | | 208 | |
| **Profit for the year** | | | **2,464** | | 2,154 | | 1,919 |
| Attributable to: | | | | | | | |
| Equity shareholders of the parent | | | **2,476** | | 2,153 | | 1,917 |
| Non-controlling interests | | | **(12)** | | 1 | | 2 |
| | | | **2,464** | | 2,154 | | 1,919 |
| **Earnings per share**[2] | | | | | | | |
| Basic | 7(a) | | **66.4p** | | 57.8p | | 51.6p |
| Diluted | 7(b) | | **66.1p** | | 57.5p | | 51.3p |

1. See note 1 on page 92.
2. Comparative amounts have been restated to reflect the impact of additional shares issued as scrip dividends.

## Unaudited commentary on the consolidated income statement

The consolidated income statement shows all revenue earned and costs incurred in the year, with the difference being the overall profit for the year.

### Revenue

Revenue for the year ended 31 March 2014 increased by £450m to £14,809m. This increase was driven by higher revenues in our UK Electricity Transmission and UK Gas Distribution businesses, principally as a result of the new RIIO regulatory arrangements. Revenue in our US Regulated businesses was also higher, reflecting higher pass-through costs such as gas and electricity commodity costs, partially offset by the end of the Niagara Mohawk deferral revenue recoveries at 31 March 2013 and the impact of the weaker dollar.

### Operating costs

Operating costs for the year ended 31 March 2014 of £11,074m were £464m higher than the prior year. This increase in costs was predominantly due to increases in pass-through costs in our UK and US Regulated businesses, together with higher depreciation and amortisation as a result of continued investment and increases in our controllable costs.

Exceptional items, remeasurements and stranded cost recoveries included in operating costs for the year ended 31 March 2014 were £39m lower than the prior year. Net exceptional gains included in 2013/14 of £55m primarily consisted of a net gain on the LIPA MSA transition in the US of £254m, a gain of £16m following the sale to a third party of a settlement award, restructuring costs of £136m and UK gas holder demolition costs of £79m. The 2013/14 results also included a gain of £16m on remeasurements of commodity contracts.

There were no major storms affecting our operations in the year ended 31 March 2014. In 2012/13, two major storms in the US, Superstorm Sandy and Storm Nemo, increased operating costs by £136m.

### Net finance costs

For the year ended 31 March 2014, net finance costs before exceptional items and remeasurements were £16m lower than 2012/13 at £1,108m, mainly due to the impact of the weaker dollar (£17m).

Finance costs for the year ended 31 March 2014 also included a gain of £93m on financial remeasurements relating to net gains and losses on derivative financial instruments.

### Taxation

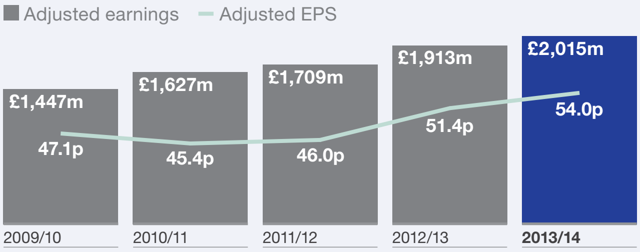
The tax charge on profits before exceptional items, remeasurements and stranded cost recoveries was £38m lower than 2012/13. This was mainly due to a 1% decrease in the UK statutory corporation tax rate in the year and a change in the UK/US profit mix where higher UK profits were taxed at the lower UK tax rate. Our tax charge was also affected by changes in tax provisions in respect of prior years.

Exceptional tax for 2013/14 included an exceptional deferred tax credit of £398m arising from a reduction in the UK corporation tax rate from 23% to 21% applicable from 1 April 2014 and a further reduction to 20% from 1 April 2015.

### Adjusted earnings and EPS

The following chart shows the five year trend in adjusted profit attributable to equity shareholders of the parent (adjusted earnings) and adjusted EPS.

**Adjusted earnings and adjusted EPS[1]**




1. All comparatives restated for IAS 19 (revised). See note 1 on page 92. Adjusted earnings and adjusted EPS are attributable to equity shareholders of the parent.

The above earnings performance translated into adjusted EPS growth in 2013/14 of 2.6p (5%).

In accordance with IAS 33, all EPS and adjusted EPS amounts for comparative periods have been restated for shares issued via scrip dividends and the bonus element of the 2010 rights issue.

### Exchange rates

Our financial results are reported in sterling. Transactions for our US operations are denominated in dollars, so the related amounts that are reported in sterling depend on the dollar to sterling exchange rate. The weighted average dollar rate weakened to \$1.62:£1 in 2013/14 from \$1.57:£1 in 2012/13. Consequently, if 2012/13 results had been translated at 2013/14 exchange rates, revenue, adjusted operating profit and operating profit reported in sterling would have been £242m, £34m and £39m lower respectively.

The statement of financial position has been translated at an exchange rate of \$1.67:£1 at 31 March 2014 (\$1.52:£1 at 31 March 2013).

**This unaudited commentary does not form part of the financial statements.**

# Consolidated statement of comprehensive income

## for the years ended 31 March

| | Notes | 2014 £m | 2013 (restated)[1] £m | 2012 (restated)[1] £m |
|---|---|---|---|---|
| **Profit for the year** | | **2,464** | 2,154 | 1,919 |
| **Other comprehensive income/(loss)** | | | | |
| Items that will never be reclassified to profit or loss | | | | |
| Remeasurements of net retirement benefit obligations | 22 | **485** | (714) | (1,140) |
| Tax on items that will never be reclassified to profit or loss | 6 | **(172)** | 179 | 342 |
| **Total items that will never be reclassified to profit or loss** | | **313** | (535) | (798) |
| Items that may be reclassified subsequently to profit or loss | | | | |
| Exchange adjustments | | **(158)** | 117 | 27 |
| Net gains/(losses) in respect of cash flow hedges | | **63** | (31) | (18) |
| Transferred to profit or loss in respect of cash flow hedges | | **27** | 73 | 19 |
| Net gains on available-for-sale investments | | **6** | 20 | 16 |
| Transferred to profit or loss on sale of available-for-sale investments | | **(14)** | (10) | (9) |
| Tax on items that may be reclassified subsequently to profit or loss | 6 | **(2)** | (15) | – |
| **Total items that may be reclassified subsequently to profit or loss** | | **(78)** | 154 | 35 |
| **Other comprehensive income/(loss) for the year, net of tax** | | **235** | (381) | (763) |
| **Total comprehensive income for the year** | | **2,699** | 1,773 | 1,156 |
| Attributable to: | | | | |
| Equity shareholders of the parent | | **2,711** | 1,772 | 1,154 |
| Non-controlling interests | | **(12)** | 1 | 2 |
| | | **2,699** | 1,773 | 1,156 |

1. See note 1 on page 92.

## Unaudited commentary on consolidated statement of comprehensive income

The consolidated statement of comprehensive income records certain items as prescribed by the accounting rules. For us, the majority of the income or expense included here relates to movements in actuarial assumptions on pension schemes and the associated tax impact. These items are not part of profit for the year, yet are important to allow the reader to gain a more comprehensive picture of our performance as a whole.

### Remeasurements of net retirement benefit obligations

We had a net gain after tax of £313m (2012/13: net cost of £535m) on our pension and other post-employment benefit schemes which is due to changes in key assumptions made in the valuation calculation and differences to actual outcomes during the year.

### Exchange adjustments

Adjustments are made when we translate the results and net assets of our companies operating outside the UK, as well as debt we have issued in foreign currencies. The net movement for the year resulted in a loss of £158m (2012/13: £117m gain).

### Net gains/(losses) in respect of cash flow hedges

The value of derivatives held to hedge cash flows is impacted by changes in expected interest rates and exchange rates. The net gain for the year was £63m (2012/13: £31m loss).

**This unaudited commentary does not form part of the financial statements.**

# Consolidated statement of changes in equity

## for the years ended 31 March

| | Called up share capital £m | Share premium account £m | Retained earnings £m | Other equity reserves[1] £m | Total shareholders' equity £m | Non-controlling interests £m | Total equity £m |
|---|---|---|---|---|---|---|---|
| Equity as at 1 April 2011 as previously reported | 416 | 1,361 | 12,153 | (4,870) | 9,060 | 9 | 9,069 |
| Impact of change in accounting policy[2] | – | – | (8) | – | (8) | – | (8) |
| Equity as at 1 April 2011 (restated) | 416 | 1,361 | 12,145 | (4,870) | 9,052 | 9 | 9,061 |
| Profit for the year[2] | – | – | 1,917 | – | 1,917 | 2 | 1,919 |
| Total other comprehensive (loss)/income for the year[2] | – | – | (798) | 35 | (763) | – | (763) |
| Total comprehensive income for the year[2] | – | – | 1,119 | 35 | 1,154 | 2 | 1,156 |
| Equity dividends | – | – | (1,319) | – | (1,319) | – | (1,319) |
| Scrip dividend related share issue[3] | 6 | (6) | 313 | – | 313 | – | 313 |
| Issue of treasury shares | – | – | 13 | – | 13 | – | 13 |
| Purchase of own shares | – | – | (4) | – | (4) | – | (4) |
| Other movements in non-controlling interests | – | – | – | – | – | (4) | (4) |
| Share-based payment | – | – | 24 | – | 24 | – | 24 |
| Tax on share-based payment | – | – | 3 | – | 3 | – | 3 |
| At 31 March 2012 (restated) | 422 | 1,355 | 12,294 | (4,835) | 9,236 | 7 | 9,243 |
| Profit for the year[2] | – | – | 2,153 | – | 2,153 | 1 | 2,154 |
| Total other comprehensive (loss)/income for the year[2] | – | – | (535) | 154 | (381) | – | (381) |
| Total comprehensive income for the year[2] | – | – | 1,618 | 154 | 1,772 | 1 | 1,773 |
| Equity dividends | – | – | (1,433) | – | (1,433) | – | (1,433) |
| Scrip dividend related share issue[3] | 11 | (11) | 623 | – | 623 | – | 623 |
| Issue of treasury shares | – | – | 19 | – | 19 | – | 19 |
| Purchase of own shares | – | – | (6) | – | (6) | – | (6) |
| Other movements in non-controlling interests | – | – | – | – | – | (3) | (3) |
| Share-based payment | – | – | 20 | – | 20 | – | 20 |
| Tax on share-based payment | – | – | (2) | – | (2) | – | (2) |
| At 31 March 2013 (restated) | 433 | 1,344 | 13,133 | (4,681) | 10,229 | 5 | 10,234 |
| Profit for the year | – | – | 2,476 | – | 2,476 | (12) | 2,464 |
| Total other comprehensive income/(loss) for the year | – | – | 313 | (78) | 235 | – | 235 |
| Total comprehensive income/(loss) for the year | – | – | 2,789 | (78) | 2,711 | (12) | 2,699 |
| Equity dividends | – | – | (1,503) | – | (1,503) | – | (1,503) |
| Scrip dividend related share issue[3] | 6 | (8) | 444 | – | 442 | – | 442 |
| Issue of treasury shares | – | – | 14 | – | 14 | – | 14 |
| Purchase of own shares | – | – | (5) | – | (5) | – | (5) |
| Other movements in non-controlling interests | – | – | (4) | – | (4) | 15 | 11 |
| Share-based payment | – | – | 20 | – | 20 | – | 20 |
| Tax on share-based payment | – | – | 7 | – | 7 | – | 7 |
| **At 31 March 2014** | **439** | **1,336** | **14,895** | **(4,759)** | **11,911** | **8** | **11,919** |

1. For further details of other equity reserves, see note 25 on page 129.
2. See note 1 on page 92.
3. Included within share premium account are costs associated with scrip dividends.

## Unaudited commentary on consolidated statement of changes in equity

The consolidated statement of changes in equity shows the additions (where it came from) and reductions (where it went) to equity. For us, the main items included here are the profit earned and dividends paid in the year.

### Dividends

We paid a total of £1,503m dividends to shareholders in the year (2012/13: £1,433m) of which £444m (2012/13: £623m) was settled via scrip issues. The Directors are proposing a final dividend of 27.54p, bringing the total dividend for the year to 42.03p, a 2.9% increase on 2012/13. The Directors intend to continue the dividend policy announced last year of increasing the annual dividend by at least the rate of RPI inflation for the foreseeable future.

**This unaudited commentary does not form part of the financial statements.**

# Consolidated statement of financial position

## as at 31 March

| | Notes | 2014 £m | 2013 (restated)[1] £m |
|---|---|---|---|
| **Non-current assets** | | | |
| Goodwill | 9 | 4,594 | 5,028 |
| Other intangible assets | 10 | 669 | 589 |
| Property, plant and equipment | 11 | 37,179 | 36,592 |
| Other non-current assets | 12 | 87 | 104 |
| Pension assets | 22 | 174 | 195 |
| Financial and other investments | 13 | 284 | 278 |
| Investments in joint ventures and associates | 14 | 351 | 371 |
| Derivative financial assets | 15 | 1,557 | 1,972 |
| Total non-current assets | | 44,895 | 45,129 |
| **Current assets** | | | |
| Inventories and current intangible assets | 16 | 268 | 291 |
| Trade and other receivables | 17 | 2,855 | 2,910 |
| Financial and other investments | 13 | 3,599 | 5,431 |
| Derivative financial assets | 15 | 413 | 273 |
| Cash and cash equivalents | 18 | 354 | 671 |
| Total current assets | | 7,489 | 9,576 |
| **Total assets** | | 52,384 | 54,705 |
| **Current liabilities** | | | |
| Borrowings | 19 | (3,511) | (3,448) |
| Derivative financial liabilities | 15 | (339) | (407) |
| Trade and other payables | 20 | (3,031) | (3,051) |
| Current tax liabilities | | (168) | (231) |
| Provisions | 23 | (282) | (308) |
| Total current liabilities | | (7,331) | (7,445) |
| **Non-current liabilities** | | | |
| Borrowings | 19 | (22,439) | (24,647) |
| Derivative financial liabilities | 15 | (824) | (1,274) |
| Other non-current liabilities | 21 | (1,841) | (1,884) |
| Deferred tax liabilities | 6 | (4,082) | (4,077) |
| Pensions and other post-retirement benefit obligations | 22 | (2,585) | (3,692) |
| Provisions | 23 | (1,363) | (1,452) |
| Total non-current liabilities | | (33,134) | (37,026) |
| **Total liabilities** | | (40,465) | (44,471) |
| **Net assets** | | 11,919 | 10,234 |
| **Equity** | | | |
| Share capital | 24 | 439 | 433 |
| Share premium account | | 1,336 | 1,344 |
| Retained earnings | | 14,895 | 13,133 |
| Other equity reserves | 25 | (4,759) | (4,681) |
| **Shareholders' equity** | | 11,911 | 10,229 |
| Non-controlling interests | | 8 | 5 |
| **Total equity** | | 11,919 | 10,234 |

1. See note 1 on page 92.

The consolidated financial statements set out on pages 82 to 154 were approved by the Board of Directors on 18 May 2014 and were signed on its behalf by:

**Sir Peter Gershon** Chairman
**Andrew Bonfield** Finance Director

## Unaudited commentary on consolidated statement of financial position

The consolidated statement of financial position sets out all the Group's assets and liabilities at the year end. As a capital-intensive business, we have significant amounts of physical assets and corresponding borrowings.

### Goodwill and other intangible assets
Goodwill and intangibles decreased by £354m to £5,263m as at 31 March 2014. This decrease primarily relates to foreign exchange movements of £472m and software amortisation of £127m, partially offset by software additions of £179m.

### Property, plant and equipment
Property, plant and equipment increased by £587m to £37,179m as at 31 March 2014. This was principally due to capital expenditure of £3,262m on the renewal and extension of our regulated networks, offset by foreign exchange movements of £1,244m, and £1,299m of depreciation in the year.

### Investments and other non-current assets
Investments in joint ventures and associates, financial and other investments and other non-current assets have decreased by £31m to £722m. This is principally due to changes in the fair value of our US commodity contract assets and available-for-sale investments.

### Inventories and current intangible assets, and trade and other receivables
Inventories and current intangible assets, and trade and other receivables have decreased by £78m to £3,123m at 31 March 2014. This decrease is principally due to foreign exchange movements of £195m, partially offset by an increase in trade and other receivables of £120m mostly due to colder weather in the US in February and March 2014 compared with 2013 resulting in increased billings for commodity costs and customer usage.

### Trade and other payables
Trade and other payables have decreased by £20m to £3,031m due to favourable foreign exchange movements of £150m, partially offset by higher payables in the UK due in part to changes in payment terms with new Gas Distribution strategic partners and increased activity on the Western Link project.

### Current tax liabilities
Current tax liabilities have decreased by £63m to £168m as at 31 March 2014. This is primarily due to higher tax payments made in 2013/14 although these were partially offset by a larger current year tax charge.

### Deferred tax liabilities
Deferred tax liabilities have increased by £5m to £4,082m as at 31 March 2014. This was primarily due to the impact of the £172m deferred tax charge on actuarial gains (a £179m tax credit in 2012/13) being offset by the impact of the reduction in the UK statutory tax rate for future periods, foreign exchange movements and the reduction in prior year charges.

### Provisions and other non-current liabilities
Provisions (both current and non-current) and other non-current liabilities decreased by £158m to £3,486m as at 31 March 2014.

Total provisions decreased by £115m in the year. The underlying movements include additions of £230m primarily relating to a provision for the demolition of certain gas holders in the UK of £79m, restructuring provisions of £86m and other provisions of £42m, more than offset by foreign exchange movements of £112m and utilisation of £288m in relation to all classes of provisions. Other non-current liabilities decreased by £43m principally due to foreign exchange movements of £47m.

### Net debt
Net debt is the aggregate of cash and cash equivalents, current financial and other investments, borrowings, and derivative financial assets and liabilities. See further analysis with the consolidated cash flow statement on page 90.

### Net pension and other post-retirement obligations
A summary of the total UK and US assets and liabilities and the overall net IAS 19 (revised) accounting deficit is shown below:

| Net plan liability | UK £m | US £m | Total £m |
|---|---|---|---|
| As at 1 April 2013 (as restated) | (1,169) | (2,328) | (3,497) |
| Exchange movements | – | 186 | 186 |
| Current service cost | (96) | (129) | (225) |
| Net interest cost | (47) | (81) | (128) |
| Curtailments and settlements – LIPA | – | 214 | 214 |
| Curtailments and settlements – other | (30) | (12) | (42) |
| Actuarial (losses)/gains | | | |
| – on plan assets | (98) | 283 | 185 |
| – on plan liabilities | 452 | (152) | 300 |
| Employer contributions | 235 | 361 | 596 |
| **As at 31 March 2014** | **(753)** | **(1,658)** | **(2,411)** |
| Represented by: | | | |
| Plan assets | – | 174 | 174 |
| Plan liabilities | (753) | (1,832) | (2,585) |
| | **(753)** | **(1,658)** | **(2,411)** |

The principal movements in net obligations during the year include a curtailment gain of £214m following the LIPA MSA transition, net actuarial gains of £485m and employer contributions of £596m. Net actuarial gains include actuarial gains on plan liabilities of £542m arising as a consequence of an increase in the UK real discount rate and the nominal discount rate in the US. This is partially offset by actuarial losses of £283m arising from increases in life expectancy in the US. Actuarial (losses)/gains on plan assets reflects the asset allocations in the different plans. In both the UK and US, returns on equities were above the assumed rate; however, UK government securities had negative returns and corporate bonds were close to nil.

Further information on our pension and other post-retirement obligations can be found in notes 22 and 29 to the consolidated financial statements. Details of the restatements made for IAS 19 (revised) can be found in note 1.

### Off balance sheet items
There were no significant off balance sheet items other than the contractual obligations shown in note 30 (b) to the consolidated financial statements, and the commitments and contingencies discussed in note 27.

Through the ordinary course of our operations, we are party to various litigation, claims and investigations. We do not expect the ultimate resolution of any of these proceedings to have a material adverse effect on our results of operations, cash flows or financial position.

**This unaudited commentary does not form part of the financial statements.**

# Consolidated cash flow statement

## for the years ended 31 March

| | Notes | 2014 £m | 2013 (restated)[1] £m | 2012 (restated)[1] £m |
|---|---|---|---|---|
| **Cash flows from operating activities** | | | | |
| Total operating profit | 2(b) | 3,735 | 3,749 | 3,535 |
| Adjustments for: | | | | |
| Exceptional items, remeasurements and stranded cost recoveries | 4 | (71) | (110) | (44) |
| Depreciation, amortisation and impairment | | 1,417 | 1,361 | 1,282 |
| Share-based payment charge | | 20 | 20 | 24 |
| Changes in working capital | | (59) | (410) | 146 |
| Changes in provisions | | (150) | (53) | (116) |
| Changes in pensions and other post-retirement benefit obligations | | (323) | (408) | (382) |
| Cash flows relating to exceptional items | | (150) | (112) | (205) |
| Cash flows relating to stranded cost recoveries | | – | – | 247 |
| Cash generated from operations | | 4,419 | 4,037 | 4,487 |
| Tax paid | | (400) | (287) | (259) |
| **Net cash inflow from operating activities** | | 4,019 | 3,750 | 4,228 |
| **Cash flows from investing activities** | | | | |
| Acquisition of investments | | (4) | (14) | (13) |
| Proceeds from sale of investments in subsidiaries | | – | 183 | 365 |
| Purchases of intangible assets | | (179) | (175) | (203) |
| Purchases of property, plant and equipment | | (2,944) | (3,214) | (3,147) |
| Disposals of property, plant and equipment | | 4 | 32 | 24 |
| Dividends received from joint ventures | | 38 | 21 | 26 |
| Interest received | | 35 | 29 | 24 |
| Net movements in short-term financial investments | | 1,720 | (2,992) | 553 |
| **Net cash flow used in investing activities** | | (1,330) | (6,130) | (2,371) |
| **Cash flows from financing activities** | | | | |
| Proceeds from issue of treasury shares | | 14 | 19 | 13 |
| Purchase of own shares | | (5) | (6) | (4) |
| Proceeds received from loans | | 1,134 | 5,062 | 1,809 |
| Repayment of loans | | (2,192) | (1,210) | (1,914) |
| Net movements in short-term borrowings and derivatives | | 37 | 452 | (49) |
| Interest paid | | (901) | (792) | (749) |
| Dividends paid to shareholders | | (1,059) | (810) | (1,006) |
| **Net cash flow (used in)/from financing activities** | | (2,972) | 2,715 | (1,900) |
| **Net (decrease)/increase in cash and cash equivalents** | 26(a) | (283) | 335 | (43) |
| Exchange movements | | (26) | 14 | – |
| Net cash and cash equivalents at start of year | | 648 | 299 | 342 |
| **Net cash and cash equivalents at end of year[2]** | 18 | 339 | 648 | 299 |

1. See note 1 on page 92.
2. Net of bank overdrafts of £15m (2013: £23m; 2012: £33m).

## Unaudited commentary on consolidated cash flow statement

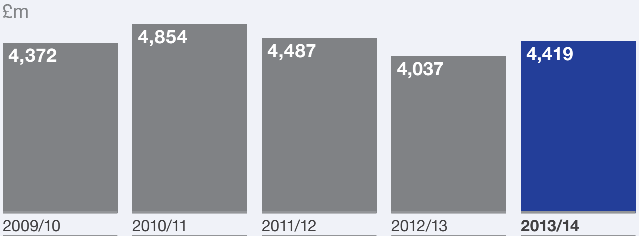
The consolidated cash flow statement shows how the cash balance has moved during the year. Cash inflows and outflows are presented to allow users to understand how they relate to the day-to-day operations of the business (operating activities); the money that has been spent or earned on assets in the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

### Reconciliation of cash flow to net debt

| | 2014 £m | 2013 £m |
|---|---|---|
| Cash generated from operations | **4,419** | 4,037 |
| Net capital expenditure | **(3,119)** | (3,357) |
| Business net cash flow | **1,300** | 680 |
| Net interest paid | **(866)** | (763) |
| Tax paid | **(400)** | (287) |
| Net acquisitions and disposals | **(4)** | 169 |
| Dividends paid | **(1,059)** | (810) |
| Other cash movements | **47** | 34 |
| Non-cash movements | **1,221** | (855) |
| **Decrease/(increase) in net debt** | **239** | (1,832) |
| Opening net debt | **(21,429)** | (19,597) |
| **Closing net debt** | **(21,190)** | (21,429) |

### Cash generated from operations

**Cash generated from operations**
£m




Cash flows from our operations are largely stable when viewed over the longer term. Our electricity and gas transmission and distribution operations in the UK and US are subject to multi-year rate agreements with regulators. In the UK, we have largely stable intra-year cash flows. However, in the US our short-term cash flows are dependent on the price of gas and electricity and the timing of customer payments. The regulatory mechanisms for recovering costs from customers can result in significant cash flow swings from year to year. Changes in volumes in the US, for example as a consequence of abnormally mild or extreme weather can affect cash flows, particularly in the winter months.

For the year ended 31 March 2014, cash flow from operations increased by £382m to £4,419m.

Adjusted operating profit before depreciation, amortisation and impairment was £81m higher year on year. Changes in working capital improved by £351m over the prior year, principally in the US due to the collection of receivables from LIPA relating to Superstorm Sandy. Partially offsetting this improvement, receivables increased due to colder weather in the US in February and March 2014, cash outflows relating to exceptional items were £38m higher due to reorganisation in the UK and LIPA MSA transition costs in the US.

### Net capital expenditure

Net capital expenditure in the year of £3,119m was £238m lower than the prior year. This was a result of lower spend in our UK regulated businesses, the impact of the weaker dollar, and reduced capital spend on the US enterprise resource system in 2013/14.

### Net interest paid

Net interest paid in 2013/14 was £866m, £103m higher than 2012/13, due to higher average net debt levels.

### Tax paid

Tax paid in the year to 31 March 2014 was £400m, £113m higher than prior year. This reflected higher tax payments in the UK on higher taxable profits.

### Net acquisitions and disposals

There were no material acquisitions or disposals in the year. The year ended 31 March 2013 included proceeds received on the disposal of our gas and electricity businesses in New Hampshire in the US.

### Dividends paid

Dividends paid in the year ended 31 March 2014 amounted to £1,059m. This was £249m higher than 2012/13, reflecting the 4% increase in the final dividend for the year ended 31 March 2013 paid in August 2013, together with a lower average scrip dividend take-up in the year. Given the relatively high scrip uptake for the dividend paid in August 2013, no scrip option was offered for the interim dividend paid in January 2014.

### Other cash movements

Other cash flows principally arise from dividends from joint ventures and movements in treasury shares.

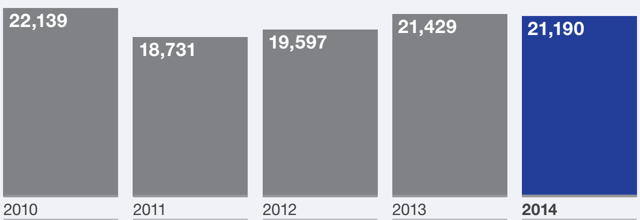
### Non-cash movements

The non-cash movements are predominantly due to the change in foreign exchange arising on net debt held in currencies other than sterling. In the year ended 31 March 2014, the dollar weakened from \$1.52 at 31 March 2013 to \$1.67 at 31 March 2014. This has caused a reduction in the sterling value of net debt.

Other non-cash movements are from changes in fair values of financial assets and liabilities and interest accretions and accruals.

### Net debt

**Net debt at 31 March**
£m




**This unaudited commentary does not form part of the financial statements.**

# Notes to the consolidated financial statements

## – analysis of items in the primary statements

### 1. Adoption of IAS 19 (revised) 'Employee benefits'

This note sets out the impact that the required adoption of IAS 19 (revised) 'Employee benefits' has had on our previously reported results. It provides details of the originally reported and the restated figures.

During the year, the Group adopted IAS 19 (revised) 'Employee benefits'. The adoption constitutes a change in accounting policy and therefore the comparative information has been restated.

The standard requires past service costs to be recognised immediately in profit or loss and all actuarial gains and losses are recognised in other comprehensive income as they occur. The standard also replaces the interest cost on the DB obligation and the expected return on plan assets with a net interest cost based on the net DB asset or liability and the discount rate, measured at the beginning of the year. The impact on the Group for the years ended 31 March 2013 and 31 March 2012 is set out in the table below:

| | As previously reported | | Restatement for IAS 19 (revised) | | **As restated** | |
|---|---|---|---|---|---|---|
| | 31 March 2013 £m | 31 March 2012 £m | 31 March 2013 £m | 31 March 2012 £m | **31 March 2013 £m** | **31 March 2012 £m** |
| **Consolidated income statement** | | | | | | |
| Operating costs | (10,605) | (10,293) | (5) | (4) | **(10,610)** | **(10,297)** |
| Total operating profit | 3,754 | 3,539 | (5) | (4) | **3,749** | **3,535** |
| Total finance income | 1,252 | 1,301 | (1,222) | (1,273) | **30** | **28** |
| Total finance costs | (2,104) | (2,288) | 1,018 | 1,100 | **(1,086)** | **(1,188)** |
| Total profit before tax | 2,920 | 2,559 | (209) | (177) | **2,711** | **2,382** |
| Total taxation | (624) | (521) | 67 | 58 | **(557)** | **(463)** |
| Profit for the year | 2,296 | 2,038 | (142) | (119) | **2,154** | **1,919** |
| **Consolidated statement of financial position** | | | | | | |
| Deferred tax liabilities | (4,076) | (3,738) | (1) | 2 | **(4,077)** | **(3,736)** |
| Pensions and other post-retirement benefit obligations | (3,694) | (3,088) | 2 | (5) | **(3,692)** | **(3,093)** |
| Total non-current liabilities | (37,027) | (31,998) | 1 | (3) | **(37,026)** | **(32,001)** |
| Total liabilities | (44,472) | (38,089) | 1 | (3) | **(44,471)** | **(38,092)** |
| Retained earnings | 13,132 | 12,297 | 1 | (3) | **13,133** | **12,294** |
| Total equity | 10,233 | 9,246 | 1 | (3) | **10,234** | **9,243** |
| **Consolidated statement of other comprehensive income** | | | | | | |
| Remeasurements of net retirement benefit obligations | (930) | (1,325) | 216 | 185 | **(714)** | **(1,140)** |
| Tax on items that will never be reclassified to profit or loss | 249 | 403 | (70) | (61) | **179** | **342** |
| Total comprehensive income for the year | 1,769 | 1,151 | 4 | 5 | **1,773** | **1,156** |
| **Consolidated statement of changes in equity** | | | | | | |
| Other comprehensive income | (527) | (887) | 146 | 124 | **(381)** | **(763)** |
| Total comprehensive income for the year | 1,769 | 1,151 | 4 | 5 | **1,773** | **1,156** |
| **Consolidated cash flow statement** | | | | | | |
| Pensions and other post-retirement benefit obligations | (413) | (386) | 5 | 4 | **(408)** | **(382)** |
| EPS – basic | 62.6p | 55.6p | (4.8)p | (4.0)p | **57.8p** | **51.6p** |
| EPS – diluted | 62.3p | 55.4p | (4.8)p | (4.1)p | **57.5p** | **51.3p** |

The restated amounts for EPS in the above table reflect the impact of additional shares issued as scrip dividends. The effect of the change in accounting policy on the statement of cash flows was immaterial, with no impact on the cash position at any of the reporting dates.

We have revised our pension and other post-retirement benefit obligations disclosures in notes 22 and 29 to provide greater clarity by separately presenting our UK and US pension plans due to their different risk profiles.

## 2. Segmental analysis

This note sets out the financial performance for the year split into the different parts of the business (operating segments). We monitor and manage the performance of these operating segments on a day-to-day basis.

### Our strategy in action

We own a portfolio of businesses that range from cash generative developed assets with minimal investment requirements (such as National Grid Metering, included within Other activities) to businesses with high levels of investment and growth (such as UK Electricity Transmission).

We generate 95% of our revenue from our regulated businesses in the UK and US. We work with our regulators to obtain agreements that balance the risks we face with the opportunity to deliver reasonable returns for our investors. When investing in non-regulated businesses we aim to leverage our core capabilities to deliver higher returns for investors.

Our regulated businesses earn revenue for the transmission, distribution and generation services they have provided during the year. In any one year, the revenue recognised may differ from that allowed under our regulatory agreements and any such timing differences are adjusted through future prices. Our non-regulated businesses earn revenue in line with their contractual terms.

Revenue primarily represents the sales value derived from the generation, transmission and distribution of energy, together with the sales value derived from the provision of other services to customers and, previously, recovery of US stranded costs during the year. It excludes value added (sales) tax and intra-group sales.

Revenue includes an assessment of unbilled energy and transportation services supplied to customers between the date of the last meter reading and the year end. This is estimated based on historical consumption and weather patterns.

Where revenue exceeds the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over-recovery, no liability is recognised, as such an adjustment relates to the provision of future services. Similarly no asset is recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under-recovery.

US stranded costs were various generation-related costs incurred prior to the divestiture of generation assets beginning in the late 1990s and costs of legacy contracts that are being recovered from customers. The recovery of stranded costs and other amounts allowed to be collected from customers under regulatory arrangements was recognised in the period in which these amounts were recoverable from customers. The recovery of stranded costs was substantially completed at 31 March 2012.

We present revenue and the results of the business analysed by operating segment, based on the information the Board of Directors uses internally for the purposes of evaluating the performance of operating segments and determining resource allocation between operating segments. The Board is National Grid's chief operating decision-making body (as defined by IFRS 8 'Operating Segments') and assesses the performance of operations principally on the basis of operating profit before exceptional items, remeasurements and stranded cost recoveries (see note 4).

Following the commencement of new RIIO regulatory arrangements in the UK, we have changed the way in which we report our operational and financial performance. We have reviewed our segmental disclosure for the year ended 31 March 2014 with the separation of our UK Transmission segment into two new segments: UK Electricity Transmission and UK Gas Transmission. We have also moved the Great Britain-France electricity interconnector from UK Electricity Transmission to Other activities. The information given in this note for the years ended 31 March 2013 and 2012 has been restated to provide a like-for-like comparison.

# Notes to the consolidated financial statements continued

## 2. Segmental analysis continued

The following table describes the main activities for each operating segment:

| | |
|---|---|
| UK Electricity Transmission | High voltage electricity transmission networks in Great Britain. |
| UK Gas Transmission | The gas transmission network in Great Britain and UK LNG storage activities. |
| UK Gas Distribution | Four of the eight regional networks of Great Britain's gas distribution system. |
| US Regulated | Gas distribution networks, electricity distribution networks and high voltage electricity transmission networks in New York and New England (including EnergyNorth and Granite State up to the date they were sold on 3 July 2012) and electricity generation facilities in New York and Massachusetts. |

Other activities primarily relate to non-regulated businesses and other commercial operations not included within the above segments, including: the Great Britain-France electricity interconnector; UK-based gas metering activities; UK property management; a UK LNG import terminal; US LNG operations; US unregulated transmission pipelines; together with corporate activities.

Sales between operating segments are priced considering the regulatory and legal requirements to which the businesses are subject. The analysis of revenue by geographical area is on the basis of destination. There are no material sales between the UK and US geographical areas.

### (a) Revenue

| | 2014 | | | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Total sales £m | Sales between segments £m | Sales to third parties £m | Total sales (restated)[1] £m | Sales between segments (restated)[1] £m | Sales to third parties (restated)[1] £m | Total sales (restated)[1] £m | Sales between segments (restated)[1] £m | Sales to third parties (restated)[1] £m |
| Operating segments | | | | | | | | | |
| UK Electricity Transmission | **3,387** | **(14)** | **3,373** | 3,110 | (15) | 3,095 | 2,811 | (16) | 2,795 |
| UK Gas Transmission | **941** | **(104)** | **837** | 1,118 | (89) | 1,029 | 983 | (8) | 975 |
| UK Gas Distribution | **1,898** | **(49)** | **1,849** | 1,714 | (47) | 1,667 | 1,605 | (52) | 1,553 |
| US Regulated | **8,040** | **–** | **8,040** | 7,918 | – | 7,918 | 7,795 | – | 7,795 |
| Other activities | **736** | **(26)** | **710** | 678 | (28) | 650 | 744 | (30) | 714 |
| | **15,002** | **(193)** | **14,809** | 14,538 | (179) | 14,359 | 13,938 | (106) | 13,832 |
| Total excluding stranded cost recoveries | | | **14,809** | | | 14,359 | | | 13,553 |
| Stranded cost recoveries | | | **–** | | | – | | | 279 |
| | | | **14,809** | | | 14,359 | | | 13,832 |
| Geographical areas | | | | | | | | | |
| UK | | | **6,759** | | | 6,421 | | | 6,000 |
| US | | | **8,050** | | | 7,938 | | | 7,832 |
| | | | **14,809** | | | 14,359 | | | 13,832 |

1. Restated to reflect the changes in operating segment presentation as described on page 93.

## 2. Segmental analysis continued

### (b) Operating profit

A reconciliation of the operating segments' measure of profit to total profit before tax is provided below. Further details of the exceptional items, remeasurements and stranded cost recoveries are provided in note 4.

| | Before exceptional items, remeasurements and stranded cost recoveries | | | After exceptional items, remeasurements and stranded cost recoveries | | |
|---|---|---|---|---|---|---|
| | **2014 £m** | 2013 (restated)[1] £m | 2012 (restated)[1] £m | **2014 £m** | 2013 (restated)[1] £m | 2012 (restated)[1] £m |
| Operating segments | | | | | | |
| UK Electricity Transmission | **1,087** | 1,049 | 876 | **1,027** | 1,020 | 876 |
| UK Gas Transmission | **417** | 531 | 453 | **406** | 517 | 453 |
| UK Gas Distribution | **904** | 794 | 763 | **780** | 763 | 739 |
| US Regulated | **1,125** | 1,254 | 1,192 | **1,388** | 1,438 | 1,156 |
| Other activities | **131** | 11 | 207 | **134** | 11 | 311 |
| | **3,664** | 3,639 | 3,491 | **3,735** | 3,749 | 3,535 |
| Geographical areas | | | | | | |
| UK | **2,723** | 2,530 | 2,347 | **2,531** | 2,456 | 2,351 |
| US | **941** | 1,109 | 1,144 | **1,204** | 1,293 | 1,184 |
| | **3,664** | 3,639 | 3,491 | **3,735** | 3,749 | 3,535 |
| Reconciliation to profit before tax | | | | | | |
| Operating profit | **3,664** | 3,639 | 3,491 | **3,735** | 3,749 | 3,535 |
| Finance income | **36** | 30 | 28 | **36** | 30 | 28 |
| Finance costs | **(1,144)** | (1,154) | (1,118) | **(1,051)** | (1,086) | (1,188) |
| Share of post-tax results of joint ventures and associates | **28** | 18 | 7 | **28** | 18 | 7 |
| **Profit before tax** | **2,584** | 2,533 | 2,408 | **2,748** | 2,711 | 2,382 |

1. See note 1 on page 92. Also restated to reflect the changes in operating segment presentation as described on page 93.

### (c) Capital expenditure, depreciation and amortisation

| | Capital expenditure | | | Depreciation and amortisation | | |
|---|---|---|---|---|---|---|
| | **2014 £m** | 2013 (restated)[1] £m | 2012 (restated)[1] £m | **2014 £m** | 2013 (restated)[1] £m | 2012 (restated)[1] £m |
| Operating segments | | | | | | |
| UK Electricity Transmission | **1,381** | 1,430 | 1,153 | **(343)** | (323) | (281) |
| UK Gas Transmission | **181** | 249 | 235 | **(172)** | (162) | (146) |
| UK Gas Distribution | **480** | 666 | 645 | **(271)** | (261) | (251) |
| US Regulated | **1,219** | 1,124 | 1,052 | **(419)** | (430) | (411) |
| Other activities | **180** | 217 | 290 | **(211)** | (185) | (183) |
| | **3,441** | 3,686 | 3,375 | **(1,416)** | (1,361) | (1,272) |
| Geographical areas | | | | | | |
| UK | **2,155** | 2,471 | 2,217 | **(938)** | (902) | (849) |
| US | **1,286** | 1,215 | 1,158 | **(478)** | (459) | (423) |
| | **3,441** | 3,686 | 3,375 | **(1,416)** | (1,361) | (1,272) |
| By asset type | | | | | | |
| Property, plant and equipment | **3,262** | 3,511 | 3,172 | **(1,289)** | (1,260) | (1,193) |
| Non-current intangible assets | **179** | 175 | 203 | **(127)** | (101) | (79) |
| | **3,441** | 3,686 | 3,375 | **(1,416)** | (1,361) | (1,272) |

1. Restated to reflect the changes in operating segment presentation as described on page 93.

Total non-current assets other than derivative financial assets, financial and other investments, deferred tax assets and pension assets located in the UK and US were £24,531m and £18,349m respectively as at 31 March 2014 (31 March 2013: UK £23,344m, US £19,340m; 31 March 2012: UK £21,793m, US £17,666m).

# Notes to the consolidated financial statements continued

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

We have summarised the results of our principal operating segments here by segment to provide direct reference to the results as disclosed in note 2. This analysis has been performed based on operating profit before exceptional items, remeasurements and stranded cost recoveries as set out in note 2 (b).

### UK Electricity Transmission

For the year ended 31 March 2014, revenue in the UK Electricity Transmission segment increased by £277m, and adjusted operating profit increased by £38m.

Net regulated income after pass-through costs was £170m higher, reflecting increases in allowed revenues under the new RIIO regulatory framework. This was partially offset by under-recoveries of revenue in the year of £60m compared with over-recoveries of £29m in the prior year. Regulated controllable costs were £27m higher due to inflation, legal fees and one-off credits in the prior year. Depreciation and amortisation was £20m higher reflecting the continued capital investment programme (investment in the year was £1,381m). Other costs were £4m lower than prior year.

### UK Gas Transmission

Revenue in the UK Gas Transmission segment decreased by £177m in 2013/14 to £941m and adjusted operating profit fell by £114m to £417m.

Net regulated income after pass-through costs was £80m lower, with lower permit income than prior year under the new RIIO arrangements. In addition, under-recoveries in the year of £21m compared with over-recoveries last year of £17m, gave rise to an adverse timing movement of £38m. Depreciation and amortisation was £10m higher due to investment, with £181m invested in the year. Partially offsetting these, other operating costs were £14m lower.

### UK Gas Distribution

UK Gas Distribution revenue increased by £184m in the year to £1,898m, and adjusted operating profit increased to £904m from £794m in 2012/13.

Net regulated income after pass-through costs was £96m higher, reflecting increases in allowed revenues under the new RIIO regulatory framework. Timing differences added another £39m, with £29m over-recoveries in 2013/14, compared with a £10m under-recovery in the prior year. Partially offsetting these, regulated controllable costs were £14m higher primarily due to inflation. Depreciation and amortisation was £10m higher reflecting the continued capital investment programme (investment in the year was £480m). Other costs were £1m higher than prior year.

### US Regulated

Revenue in our US Regulated businesses was £122m higher at £8,040m, and adjusted operating profit fell by £129m to £1,125m.

The weaker dollar reduced operating profit in the year by £38m. Excluding the impact of foreign exchange, net regulated income fell by £52m, principally due to the end of deferral income recoveries for Niagara Mohawk at 31 March 2013. Timing differences added another £29m profit compared with prior year. Regulated controllable costs increased by £89m at constant currency as a result of inflation and wage increases, higher insurance costs post Superstorm Sandy, and cost true-ups identified during the implementation of new financial systems. Other operating costs (excluding major storms) increased by £61m at constant currency due to the higher cost of non-major storm remediation, higher property taxes and depreciation of the new US enterprise resource system.

There were no major storms affecting our operations in the year ended 31 March 2014. In 2012/13, two major storms in the US, Superstorm Sandy and Storm Nemo, reduced operating profit within US Regulated by £82m at constant currency.

Our capital investment programme continues in the US, with a further £1,219m invested in 2013/14, including gas leak reduction programmes and gas growth and connection spend.

### Other activities

Revenue in Other activities increased by £58m to £736m in the year ended 31 March 2014. Adjusted operating profit was £120m higher at £131m.

There was no repeat of the major storm cost of £51m incurred in our insurance captive in the prior year due to Superstorm Sandy. Operating profit in the French interconnector was £62m higher as a result of strong auction revenues this year. In our other non-regulated businesses, adjusted operating profit was £7m higher due to improved results in our UK metering business and insurance captive, partially offset by higher costs associated with the stabilisation of the new US enterprise resource system.

Capital expenditure in our Other activities was £37m lower at £180m, principally reflecting reduced capital spend on the new US enterprise resource system.

**This unaudited commentary does not form part of the financial statements.**

## 3. Operating costs

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

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

| | Before exceptional items, remeasurements and stranded cost recoveries | | | Exceptional items, remeasurements and stranded cost recoveries | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2014 £m** | 2013 (restated)[1] £m | 2012 (restated)[1] £m | **2014 £m** | 2013 (restated)[1] £m | 2012 (restated)[1] £m | **2014 £m** | 2013 (restated)[1] £m | 2012 (restated)[1] £m |
| Depreciation and amortisation | **1,416** | 1,361 | 1,267 | **–** | – | 5 | **1,416** | 1,361 | 1,272 |
| Payroll costs | **1,373** | 1,434 | 1,381 | **59** | 22 | 82 | **1,432** | 1,456 | 1,463 |
| Purchases of electricity | **1,513** | 1,251 | 1,356 | **(49)** | (111) | 89 | **1,464** | 1,140 | 1,445 |
| Purchases of gas | **1,722** | 1,384 | 1,518 | **33** | (69) | 5 | **1,755** | 1,315 | 1,523 |
| Rates and property taxes | **963** | 969 | 955 | **–** | – | – | **963** | 969 | 955 |
| Balancing Services Incentive Scheme | **872** | 805 | 818 | **–** | – | – | **872** | 805 | 818 |
| Payments to other UK network owners | **630** | 487 | 407 | **–** | – | – | **630** | 487 | 407 |
| Other | **2,656** | 3,029 | 2,360 | **(114)** | 48 | 54 | **2,542** | 3,077 | 2,414 |
| | **11,145** | 10,720 | 10,062 | **(71)** | (110) | 235 | **11,074** | 10,610 | 10,297 |
| Operating costs include: | | | | | | | | | |
| Inventory consumed | | | | | | | **422** | 389 | 360 |
| Operating leases | | | | | | | **115** | 109 | 97 |
| Research and development expenditure | | | | | | | **12** | 15 | 15 |

1. See note 1 on page 92.

### (a) Payroll costs

| | **2014 £m** | 2013 (restated)[1] £m | 2012 (restated)[1] £m |
|---|---|---|---|
| Wages and salaries[2] | **1,575** | 1,596 | 1,566 |
| Social security costs | **126** | 120 | 116 |
| Pension costs (note 22) | **245** | 231 | 231 |
| Share-based payment | **20** | 20 | 24 |
| Severance costs (excluding pension costs) | **30** | 16 | 35 |
| | **1,996** | 1,983 | 1,972 |
| Less: payroll costs capitalised | **(564)** | (527) | (509) |
| | **1,432** | 1,456 | 1,463 |

1. See note 1 on page 92.
2. Included within wages and salaries are US other post-retirement benefit costs of £44m (2013: £43m; 2012: £60m). For further information refer to note 22 on page 122.

### (b) Number of employees

| | **31 March 2014 Number** | **Monthly average 2014 Number** | 31 March 2013 Number[1] | Monthly average 2013 Number[1] | 31 March 2012 Number[1] | Monthly average 2012 Number[1] |
|---|---|---|---|---|---|---|
| UK | **9,693** | **9,641** | 9,990 | 9,816 | 9,696 | 9,769 |
| US | **14,216** | **15,094** | 15,438 | 15,555 | 15,843 | 16,080 |
| | **23,909** | **24,735** | 25,428 | 25,371 | 25,539 | 25,849 |

1. Comparatives have been re-presented on a basis consistent with the current year classification.

The vast majority of employees in the US are either directly or indirectly employed in the transmission, distribution and generation of electricity or the distribution of gas, while those in the UK are either directly or indirectly employed in the transmission and distribution of gas or the transmission of electricity. At 31 March 2014, there were 2,044 (2013: 2,151; 2012: 2,357) employees in other operations, excluding shared services.

# Notes to the consolidated financial statements continued

## 3. Operating costs continued

### (c) Key management compensation

| | 2014 £m | 2013 £m | 2012 £m |
|---|---|---|---|
| Short-term employee benefits | **9** | 8 | 10 |
| Post-employment benefits | **1** | 3 | 6 |
| Share-based payment | **5** | 5 | 5 |
| | **15** | 16 | 21 |

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

### (d) Directors' emoluments

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

### (e) Auditors' remuneration

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

| | 2014 £m | 2013 £m | 2012 £m |
|---|---|---|---|
| **Audit fees[1] payable to the parent Company's auditors and their associates in respect of:** | | | |
| Audit of the parent Company's individual and consolidated financial statements | **0.9** | 1.1 | 1.1 |
| The auditing of accounts of any associate of the Company | **7.8** | 6.0 | 5.2 |
| Other services supplied[2] | **2.3** | 2.7 | 2.3 |
| | **11.0** | 9.8 | 8.6 |
| **Total other services[3]** | | | |
| Tax fees[4] | | | |
| Tax compliance services | **0.5** | 0.5 | 0.5 |
| Tax advisory services | **0.3** | 0.3 | 0.2 |
| All other fees[5] | | | |
| Other assurance services | **0.1** | 0.1 | 0.3 |
| Services relating to corporate finance transactions not covered above | **–** | 0.3 | 0.2 |
| Other non-audit services not covered above | **0.8** | 1.1 | 2.6 |
| | **1.7** | 2.3 | 3.8 |
| **Total auditors' remuneration** | **12.7** | 12.1 | 12.4 |

1. Audit fees in each year represent fees for the audit of the Company's financial statements and regulatory reporting for the years ended 31 March 2014, 2013 and 2012, and the review of interim financial statements for the six month periods ended 30 September 2013, 2012 and 2011 respectively.
2. Other services supplied represent fees payable for services in relation to other statutory filings or engagements that are required to be carried out by the auditors. In particular, this includes fees for reports under section 404 of the US Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley) and audit reports on regulatory returns.
3. There were no audit related fees as described in Item 16C(b) of Form 20-F.
4. Tax fees include amounts charged for tax compliance, tax advice and tax planning. Total tax fees for the year ended 31 March 2014 were £0.8m (2013: £0.8m; 2012: £0.7m).
5. All other fees include amounts relating to the review of US pensions and other post-retirement benefits census data and sundry services, all of which have been subject to approval by the Audit Committee. Total other fees for the year ended 31 March 2014 were £0.9m (2013: £1.5m; 2012: £3.1m).

In addition, fees of £0.1m were incurred in 2014 in relation to the audits of the pension schemes of the Company (2013: £0.1m; 2012: £0.1m).

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

## 4. Exceptional items, remeasurements and stranded cost recoveries

To monitor our financial performance, we use a profit measure that excludes certain income and expenses. We call that measure 'business performance'. We exclude items from business performance because we think these items are individually important to understanding our financial performance. If included, these items could distort understanding of our performance for the year and the comparability between periods. This note analyses these items, which are included in our results for the year but are excluded from business performance.

Our financial performance is analysed into two components: business performance, which excludes exceptional items, remeasurements and stranded cost recoveries; and exceptional items, remeasurements and stranded cost recoveries. Business performance is used by management to monitor financial performance as it is considered that it improves the comparability of our reported financial performance from year to year. Business performance subtotals are presented on the face of the income statement or in the notes to the financial statements.

Items of income or expense that are considered by management for designation as exceptional items include such items as significant restructurings, write-downs or impairments of non-current assets, significant changes in environmental or decommissioning provisions, integration of acquired businesses, gains or losses on disposals of businesses or investments and debt redemption costs as a consequence of transactions such as significant disposals or issues of equity.

Costs arising from restructuring programmes include redundancy costs. Redundancy costs are charged to the income statement in the year in which a commitment is made to incur the costs and the main features of the restructuring plan have been announced to affected employees.

Remeasurements comprise gains or losses recorded in the income statement arising from changes in the fair value of commodity contracts and of derivative financial instruments to the extent that hedge accounting is not achieved or is not effective. These fair values increase or decrease because of changes in commodity and financial indices and prices over which we have no control.

Stranded cost recoveries represent the recovery, through charges to electricity customers in upstate New York and New England, of historical generation-related costs, related to generation assets that are no longer owned by National Grid. Such costs have been recovered from customers as permitted by regulatory agreements, with substantially all having been recovered by 31 March 2012.

# Notes to the consolidated financial statements continued

## 4. Exceptional items, remeasurements and stranded cost recoveries continued

| | 2014 £m | 2013 £m | 2012 £m |
|---|---|---|---|
| **Included within operating profit** | | | |
| Exceptional items | | | |
| Restructuring costs[1] | (136) | (87) | (101) |
| Gas holder demolition costs[2] | (79) | – | – |
| LIPA MSA transition[3] | 254 | – | (64) |
| Other[4] | 16 | – | 1 |
| Environmental charges | – | – | (55) |
| Net gain on disposal of businesses[5] | – | 3 | 97 |
| | 55 | (84) | (122) |
| Remeasurements – commodity contracts[6] | 16 | 180 | (94) |
| Stranded cost recoveries[7] | – | 14 | 260 |
| | 71 | 110 | 44 |
| **Included within finance costs** | | | |
| Remeasurements – net gains/(losses) on derivative financial instruments[8] | 93 | 68 | (70) |
| | 93 | 68 | (70) |
| **Total included within profit before tax** | 164 | 178 | (26) |
| **Included within taxation** | | | |
| Exceptional credits/(charges) arising on items not included in profit before tax | | | |
| Deferred tax credit arising on the reduction in the UK corporation tax rate[9] | 398 | 128 | 242 |
| Deferred tax charge arising from an increase in US state income tax rates[10] | (8) | – | – |
| Tax on exceptional items | (57) | 31 | 54 |
| Tax on remeasurements[6,8] | (36) | (92) | 42 |
| Tax on stranded cost recoveries | – | (5) | (104) |
| | 297 | 62 | 234 |
| **Total exceptional items, remeasurements and stranded cost recoveries after tax** | 461 | 240 | 208 |
| **Analysis of total exceptional items, remeasurements and stranded cost recoveries after tax** | | | |
| Exceptional items after tax | 388 | 75 | 174 |
| Remeasurements after tax | 73 | 156 | (122) |
| Stranded cost recoveries after tax | – | 9 | 156 |
| **Total** | 461 | 240 | 208 |

1. Restructuring costs for the period of £136m related to the continued restructuring of our UK operations in preparedness to deliver RIIO, other transformation-related initiatives in the UK and US and an associated software impairment for licences that will no longer be used.

   Restructuring costs for 2013 included: costs related to the restructuring of our UK operations of £66m in preparedness for delivering RIIO; costs for transformation-related initiatives in the UK and US of £31m; and a credit of £10m for the release of restructuring provisions in the UK recognised in prior years. For the year ended 31 March 2012, restructuring costs included: costs for the restructuring of our US operations of £58m, which included severance costs and pension and other post-retirement curtailment gains and losses; costs for transformation-related initiatives of £54m; and a credit of £11m for the release of restructuring provisions in the UK recognised in prior years.
2. A provision of £79m (2013: £nil) has been made for the demolition of certain non-operational gas holders in the UK.
3. A net gain of £254m (2013: £nil) has been recognised in the year ended 31 March 2014. This includes a pension curtailment and settlement gain of £214m for employees who transferred to a new employer following the cessation of the Management Services Agreement (MSA) with LIPA on 31 December 2013. There was also a gain of £142m following the extinguishment of debt obligations of £98m and a £56m cash payment to be received, in compensation for the Company forgiving a historic pension receivable and carrying charges. These gains were offset by transition costs and other provisions incurred to effect the transition. For the year ended 31 March 2012, an impairment charge of £64m was recognised, representing intangibles (originally recognised on the acquisition of KeySpan) related to our LIPA MSA contract. This amount was previously disclosed as impairment charges and related costs.
4. During the year ended 31 March 2014, £16m (2013: £nil) was received following the sale to a third party of a settlement award which arose as a result of a legal ruling in 2008. For the year ended 31 March 2012, an amortisation charge of £5m in relation to acquisition-related intangibles was offset by a release of £6m of unutilised provisions in our UK metering business.
5. For the year ended 31 March 2013, we recognised a gain of £3m on the disposal of two subsidiaries in New Hampshire. During the year ended 31 March 2012, we sold two other subsidiaries resulting in a gain on disposal of £72m. We also recognised gains of £25m in relation to disposals of businesses in prior years, representing the release of various unutilised provisions.
6. Remeasurements – commodity contracts represent mark-to-market movements on certain physical and financial commodity contract obligations in the US. These contracts primarily relate to the forward purchase of energy for supply to customers, or to the economic hedging thereof, that are required to be measured at fair value and that do not qualify for hedge accounting. Under the existing rate plans in the US, commodity costs are recoverable from customers although the timing of recovery may differ from the pattern of costs incurred.
7. For the year ended 31 March 2013, stranded cost recoveries of £14m substantially represented the release of an unutilised provision recognised in a prior period. For the year ended 31 March 2012, stranded cost recoveries on a pre-tax basis consisted of revenue of £279m offset by operating costs of £19m. This represented the recovery of some of our historical investments in generating plants that were divested as part of the restructuring and wholesale power deregulation process in New England and New York during the 1990s.
8. Remeasurements – net gains/(losses) on derivative financial instruments comprise gains/(losses) arising on derivative financial instruments reported in the income statement. These exclude gains and losses for which hedge accounting has been effective, which have been recognised directly in other comprehensive income or which are offset by adjustments to the carrying value of debt. The tax charge in the year includes a credit of £nil (2013: £1m; 2012: £1m) in respect of prior years.
9. The exceptional tax credit arises from reductions in the UK corporation tax rate, from 23% to 21% applicable from 1 April 2014, and a further reduction from 21% to 20% applicable from 1 April 2015. The rate reductions were enacted in the Finance Act 2013. Other UK tax legislation also reduced the UK corporation tax rate in the prior periods (2013: from 24% to 23%; 2012: from 26% to 24%). These reductions have resulted in a decrease in deferred tax liabilities.
10. The exceptional tax charge arises from a net increase in US state income tax rates. Effective from 1 April 2014, the state income tax rate for Massachusetts regulated utilities increased from 6.5% to 8% and, effective from 1 April 2016, the state income tax rate for New York will decrease from 7.1% to 6.5%.

## 5. Finance income and costs

This note details the interest income generated by our financial assets and interest expense incurred on our financial liabilities. It also includes the expected return on our pension and other post-retirement assets, which is offset by the interest payable on pension and other post-retirement obligations and presented on a net basis. In reporting business performance, we adjust net financing costs to exclude any net gains or losses on derivative financial instruments included in remeasurements.

| | 2014 £m | 2013 (restated)[1] £m | 2012 (restated)[1] £m |
|---|---|---|---|
| **Finance income** | | | |
| Interest income on financial instruments | | | |
| Bank deposits and other financial assets | **22** | 20 | 19 |
| Gains on disposal of available-for-sale investments | **14** | 10 | 9 |
| **Finance income** | **36** | 30 | 28 |
| **Finance costs** | | | |
| Net interest on pensions and other post-retirement benefit obligations | **(128)** | (135) | (103) |
| Interest expense on financial liabilities held at amortised cost | | | |
| Bank loans and overdrafts | **(61)** | (65) | (84) |
| Other borrowings | **(1,109)** | (1,052) | (1,105) |
| Derivatives | **79** | 51 | 122 |
| Unwinding of discounts on provisions | **(73)** | (75) | (72) |
| Less: interest capitalised[2] | **148** | 122 | 124 |
| **Finance costs before exceptional items and remeasurements** | **(1,144)** | (1,154) | (1,118) |
| **Remeasurements** | | | |
| Net gains/(losses) on derivative financial instruments included in remeasurements[3]: | | | |
| Ineffectiveness on derivatives designated as: | | | |
| Fair value hedges[4] | **22** | 17 | 9 |
| Cash flow hedges | **4** | (7) | 14 |
| Net investment hedges | **38** | (26) | (15) |
| Net investment hedges – undesignated forward rate risk | **(7)** | 26 | 39 |
| Derivatives not designated as hedges or ineligible for hedge accounting | **36** | 58 | (117) |
| **Exceptional items and remeasurements included within finance costs (note 4)** | **93** | 68 | (70) |
| **Finance costs** | **(1,051)** | (1,086) | (1,188) |
| **Net finance costs** | **(1,015)** | (1,056) | (1,160) |

1. See note 1 on page 92.
2. Interest on funding attributable to assets in the course of construction was capitalised during the year at a rate of 4.5% (2013: 4.4%; 2012: 5.2%).
3. Includes a net foreign exchange gain on financing activities of £268m (2013: £32m loss; 2012: £280m gain) offset by foreign exchange gains and losses on derivative financial instruments measured at fair value.
4. Includes a net loss on instruments designated as fair value hedges of £183m (2013: £67m gain; 2012: £233m gain) offset by a net gain of £205m (2013: £50m loss; 2012: £224m loss) arising from fair value adjustments to the carrying value of debt.

# Notes to the consolidated financial statements continued

## 6. Taxation

Tax is payable in the territories where we operate, mainly the UK and US. This note gives further details of the 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.

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 have been enacted or substantively enacted by the reporting date.

The calculation of the Group's total tax charge involves a degree of estimation and judgement, and management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

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 liabilities are recognised on taxable temporary differences arising on investments in subsidiaries and jointly controlled entities except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

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 taxable 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 Company and its subsidiaries intend to settle their current tax assets and liabilities on a net basis.

# 6. Taxation continued

## Tax charged/(credited) to the income statement

| | 2014 £m | 2013 (restated)[1] £m | 2012 (restated)[1] £m |
|---|---|---|---|
| Tax before exceptional items, remeasurements and stranded cost recoveries | **581** | 619 | 697 |
| Exceptional tax on items not included in profit before tax (note 4) | **(390)** | (128) | (242) |
| Tax on other exceptional items, remeasurements and stranded cost recoveries | **93** | 66 | 8 |
| Tax on total exceptional items, remeasurements and stranded cost recoveries (note 4) | **(297)** | (62) | (234) |
| **Total tax charge** | **284** | 557 | 463 |

1. See note 1 on page 92.

## Taxation as a percentage of profit before tax

| | 2014 % | 2013 (restated)[1] % | 2012 (restated)[1] % |
|---|---|---|---|
| Before exceptional items, remeasurements and stranded cost recoveries | **22.5** | 24.4 | 28.9 |
| After exceptional items, remeasurements and stranded cost recoveries | **10.3** | 20.5 | 19.4 |

1. See note 1 on page 92.

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

| | 2014 £m | 2013 (restated)[1] £m | 2012 (restated)[1] £m |
|---|---|---|---|
| **Current tax** | | | |
| UK corporation tax at 23% (2013: 24%; 2012: 26%) | **355** | 306 | 186 |
| UK corporation tax adjustment in respect of prior years | **(9)** | (17) | (5) |
| | **346** | 289 | 181 |
| Overseas corporation tax | **54** | 50 | 98 |
| Overseas corporation tax adjustment in respect of prior years | **(88)** | (222) | (144) |
| | **(34)** | (172) | (46) |
| **Total current tax** | **312** | 117 | 135 |
| **Deferred tax** | | | |
| UK deferred tax | **(292)** | 35 | (12) |
| UK deferred tax adjustment in respect of prior years | **(3)** | (17) | (18) |
| | **(295)** | 18 | (30) |
| Overseas deferred tax | **276** | 283 | 191 |
| Overseas deferred tax adjustment in respect of prior years | **(9)** | 139 | 167 |
| | **267** | 422 | 358 |
| **Total deferred tax** | **(28)** | 440 | 328 |
| | | | |
| **Total tax charge** | **284** | 557 | 463 |

1. See note 1 on page 92.

Adjustments in respect of prior years include the following amounts that relate to exceptional items, remeasurements and stranded cost recoveries: £nil (2013: £1m credit; 2012: £1m credit).

# Notes to the consolidated financial statements continued

## 6. Taxation continued

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

| | 2014 £m | 2013 (restated)[1] £m | 2012 (restated)[1] £m |
|---|---|---|---|
| **Current tax** | | | |
| Share-based payment | **(3)** | 1 | (3) |
| Available-for-sale investments | **(5)** | – | – |
| **Deferred tax** | | | |
| Available-for-sale investments | **2** | 2 | 2 |
| Cash flow hedges | **5** | 13 | (2) |
| Share-based payment | **(4)** | 1 | – |
| Remeasurements of net retirement benefit obligations | **172** | (179) | (342) |
| | **167** | (162) | (345) |
| Total tax recognised in the statement of comprehensive income | **174** | (164) | (342) |
| Total tax relating to share-based payment recognised directly in equity | **(7)** | 2 | (3) |
| | **167** | (162) | (345) |

1. See note 1 on page 92.

The tax charge for the year after exceptional items, remeasurements and stranded cost recoveries is lower (2013: lower; 2012: lower) than the standard rate of corporation tax in the UK of 23% (2013: 24%; 2012: 26%).

| | Before exceptional items, remeasurements and stranded cost recoveries 2014 £m | After exceptional items, remeasurements and stranded cost recoveries 2014 £m | Before exceptional items, remeasurements and stranded cost recoveries 2013 (restated)[1] £m | After exceptional items, remeasurements and stranded cost recoveries 2013 (restated)[1] £m | Before exceptional items, remeasurements and stranded cost recoveries 2012 (restated)[1] £m | After exceptional items, remeasurements and stranded cost recoveries 2012 (restated)[1] £m |
|---|---|---|---|---|---|---|
| **Profit before tax** | | | | | | |
| Before exceptional items, remeasurements and stranded cost recoveries | **2,584** | **2,584** | 2,533 | 2,533 | 2,408 | 2,408 |
| Exceptional items, remeasurements and stranded cost recoveries | **–** | **164** | – | 178 | – | (26) |
| **Profit before tax** | **2,584** | **2,748** | 2,533 | 2,711 | 2,408 | 2,382 |
| Profit before tax multiplied by UK corporation tax rate of 23% (2013: 24%; 2012: 26%) | **594** | **632** | 608 | 651 | 626 | 619 |
| Effect of: | | | | | | |
| Adjustments in respect of prior years | **(109)** | **(109)** | (116) | (117) | 1 | – |
| Expenses not deductible for tax purposes | **32** | **284** | 37 | 169 | 36 | 55 |
| Non-taxable income | **(24)** | **(268)** | (24) | (152) | (19) | (30) |
| Adjustment in respect of foreign tax rates | **98** | **138** | 116 | 140 | 63 | 63 |
| Impact of share-based payment | **(3)** | **(3)** | 2 | 2 | 1 | 1 |
| Deferred tax impact of change in UK and US tax rates | **–** | **(390)** | – | (128) | – | (242) |
| Other | **(7)** | **–** | (4) | (8) | (11) | (3) |
| **Total tax** | **581** | **284** | 619 | 557 | 697 | 463 |
| | **%** | **%** | % | % | % | % |
| **Effective tax rate** | **22.5** | **10.3** | 24.4 | 20.5 | 28.9 | 19.4 |

1. See note 1 on page 92.

### Factors that may affect future tax charges

The Finance Act 2013 (the Act) was substantively enacted on 2 July 2013. The Act further reduced the main rate of UK corporation tax to 21% with effect from 1 April 2014 and 20% from 1 April 2015.

The reduction in the UK corporation tax rate to 20% from 1 April 2015 has been enacted and deferred tax balances have been calculated at this rate.

Effective from 1 April 2014, the state income tax rate for Massachusetts regulated utilities increased from 6.5% to 8% and, effective from 1 April 2016, the state income tax rate for New York will decrease from 7.1% to 6.5%. Neither of these rate changes is expected to have a material impact on the Group's effective tax rate.

## 6. Taxation continued

### Taxation 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:

| | Accelerated tax depreciation £m | Share-based payment £m | Pensions and other post-retirement benefits (restated)[1] £m | Financial instruments £m | Other net temporary differences £m | Total (restated)[1] £m |
|---|---|---|---|---|---|---|
| **Deferred tax (assets)/liabilities** | | | | | | |
| Deferred tax assets at 31 March 2012 | (1) | (18) | (1,173) | (98) | (702) | (1,992) |
| Deferred tax liabilities at 31 March 2012 | 5,484 | – | 128 | 9 | 109 | 5,730 |
| At 1 April 2012 as previously reported | 5,483 | (18) | (1,045) | (89) | (593) | 3,738 |
| Impact of change in accounting policy[1] | – | – | (2) | – | – | (2) |
| At 1 April 2012 (restated) | 5,483 | (18) | (1,047) | (89) | (593) | 3,736 |
| Exchange adjustments | 149 | – | (47) | (1) | (32) | 69 |
| Charged/(credited) to income statement | 329 | 2 | 65 | 68 | (23) | 441 |
| Charged/(credited) to other comprehensive income and equity | – | 1 | (179) | 15 | – | (163) |
| Other | – | – | – | – | (6) | (6) |
| At 31 March 2013 (restated) | 5,961 | (15) | (1,208) | (7) | (654) | 4,077 |
| Deferred tax assets at 31 March 2013 | (2) | (15) | (1,362) | (16) | (777) | (2,172) |
| Deferred tax liabilities at 31 March 2013 | 5,963 | – | 154 | 9 | 123 | 6,249 |
| At 1 April 2013 | 5,961 | (15) | (1,208) | (7) | (654) | 4,077 |
| Exchange adjustments | (282) | – | 78 | – | 59 | (145) |
| (Credited)/charged to income statement | (30) | (3) | 141 | (7) | (126) | (25) |
| (Credited)/charged to other comprehensive income and equity | – | (4) | 172 | 7 | – | 175 |
| **At 31 March 2014** | **5,649** | **(22)** | **(817)** | **(7)** | **(721)** | **4,082** |
| Deferred tax assets at 31 March 2014 | (1) | (22) | (960) | (13) | (796) | (1,792) |
| Deferred tax liabilities at 31 March 2014 | 5,650 | – | 143 | 6 | 75 | 5,874 |
| | 5,649 | (22) | (817) | (7) | (721) | 4,082 |

1. See note 1 on page 92.

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an 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 £4,082m (2013: £4,077m).

At the reporting date there were no material current deferred tax assets or liabilities (2013: £nil).

Deferred tax assets in respect of capital losses, trading losses and non-trade deficits have not been recognised as their future recovery is uncertain or not currently anticipated. The deferred tax assets not recognised are as follows:

| | **2014 £m** | 2013 £m |
|---|---|---|
| Capital losses | **274** | 323 |
| Non-trade deficits | **1** | 1 |
| Trading losses | **5** | 11 |

The capital losses and non-trade deficits that arise in the UK are available to carry forward indefinitely. However, the capital losses can only be offset against specific types of future capital gains and non-trade deficits against specific future non-trade profits. The trading losses arising in the US have up to a 20 year carry forward time limit.

The aggregate amount of temporary differences associated with the unremitted earnings of overseas subsidiaries and joint ventures for which deferred tax liabilities have not been recognised at the reporting date is approximately £2,118m (2013: £1,817m). No liability is recognised in respect of the differences because the Company and its subsidiaries are in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future. In addition, as a result of a change in UK tax legislation, which largely exempts overseas dividends received on or after 1 July 2009 from UK tax, the temporary differences are unlikely to lead to additional tax.

# Notes to the consolidated financial statements continued

## Unaudited commentary on taxation

### Tax strategy
National Grid manages its tax affairs in a proactive and responsible way in order to comply with all relevant legislation and minimise reputational risk. We have a good working relationship with all relevant tax authorities and actively engage with them in order to ensure that they are fully aware of our view of the tax implications of our business initiatives. Management responsibility and oversight for our tax strategy, which is approved by the Finance Committee, rests with the Finance Director and the Global Tax and Treasury Director who monitor our tax activities and report to the Finance Committee.

### Total UK tax contribution
National Grid has taken the decision to provide additional information in respect of its total UK tax contribution and first disclosed this in last year's annual report. This year we have again disclosed information in respect of our total UK tax contribution for consistency and to aid transparency in an area in which there has been increasing public interest. As was the case in the prior year, the total amount of taxes we pay and collect in the UK year on year is significantly more than just the corporation tax which we pay on our UK profits. Within the total, we again include significant other taxes paid such as business rates and taxes on employment together with employee taxes and other indirect taxes.

For 2013/14 our total tax contribution to the UK Exchequer was £1.4bn (2012/13: £1.2bn). Taxes borne in 2014 were £733m, an 8% increase on taxes borne in 2013 of £678m and primarily due to higher corporation tax payments in the current year. Our 2012/13 total tax contribution of £1.2bn resulted in National Grid being the 17th highest contributor of UK taxes based on the results of the Hundred Group's 2013 Total Tax Contribution Survey, a position commensurate with the size of our business and capitalisation relative to other contributors to the survey. In 2012 we were in 16th position. In 2013 we ranked 9th in respect of taxes borne.

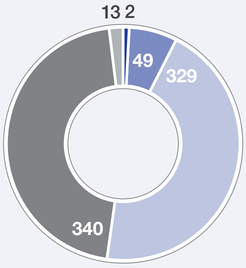
Of course, National Grid's contribution to the UK economy is broader than just the taxes it pays over to and collects on behalf of HMRC. The Hundred Group's 2013 Total Tax Contribution Survey ranks National Grid in 4th place in respect of UK capital expenditure on fixed assets and we also rank highly in respect of investment in research and development. National Grid's economic contribution also supports a significant number of UK jobs in our supply chain.

The most significant amounts making up the 2013/14 total tax contribution were as follows:

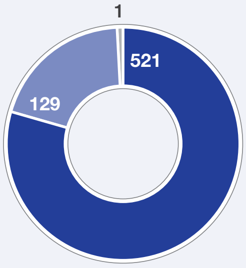
**UK total tax contribution 2013/14**

VAT  PAYE and NIC  UK corporation tax
Business rates  Other

Taxes borne £m




Taxes collected £m




### Tax transparency
The UK tax charge for the year disclosed in the accounts in accordance with accounting standards and the UK corporation tax paid during the year will differ. For transparency we have included a reconciliation below of the tax charge per the income statement to the UK corporation tax paid in 2013/14.

The tax charge for the Group as reported in the income statement is £284m (2012/13: £557m). The UK tax charge is £51m (2012/13: £307m) and UK corporation tax paid was £329m (2012/13: £243m), with the principal differences between these two measures as follows:

| Reconciliation of UK total tax charge to UK corporation tax paid | Year ended 31 March 2014 £m | 2013 (restated)[1] £m |
|---|---|---|
| Total UK tax charge (current tax £346m (2013: £289m) and deferred tax £295m credit (2013: £18m charge)) | **51** | 307 |
| Adjustment for non-cash deferred tax credit/(charge) | **295** | (18) |
| Adjustment for the current tax credit in respect of prior years | **9** | 17 |
| UK current tax charge | **355** | 306 |
| UK corporation tax instalment payments in respect of current year not payable until the following year | **(179)** | (155) |
| UK corporation tax instalment payments in respect of prior years paid in current year | **153** | 92 |
| UK corporation tax paid | **329** | 243 |

1. All comparatives restated for IAS 19 (revised). See note 1 on page 92.

### Tax losses
We have total unrecognised deferred tax assets in respect of losses of £280m (2012/13: £335m) of which £274m (2012/13: £319m) are capital losses in the UK as set out on page 105. These losses arose as a result of the disposal of certain businesses or assets and may be available to offset against future capital gains in the UK.

### Development of future tax policy
We believe that the continued development of a coherent and transparent tax policy in the UK is critical to help drive growth in the economy.

We continue to contribute to research into the structure of business taxation and its economic impact by contributing to the funding of the Oxford University Centre for Business Taxation at the Saïd Business School.

We are a member of a number of industry groups which participate in the development of future tax policy, including the Hundred Group, which represents the views of finance directors of FTSE 100 companies and several other large UK companies. Our Finance Director is Chairman of its Tax Committee. This helps to ensure that we are engaged at the earliest opportunity on taxation issues which affect our business. For example, in the current year we have engaged with and responded to a number of HMRC consultations, the subject matter of which has a direct impact on taxes borne or collected by our business, and reviewed numerous others with a potential impact.

**This unaudited commentary does not form part of the financial statements.**

## 7. Earnings per share (EPS)

EPS is the amount of post-tax profit attributable to each ordinary share. Basic EPS is calculated on profit for the year attributable to equity shareholders divided by the weighted average number of shares in issue during the year. Diluted EPS shows what the impact would be if all outstanding share options were exercised and treated as ordinary shares at year end.

Adjusted EPS, excluding exceptional items, remeasurements and stranded cost recoveries, are provided to reflect the business performance subtotals used by the Company. For further details of exceptional items, remeasurements and stranded cost recoveries, see note 4.

### (a) Basic earnings per share

| | Earnings 2014 £m | Earnings per share 2014 pence | Earnings 2013 (restated)[1] £m | Earnings per share 2013 (restated)[1,2] pence | Earnings 2012 (restated)[1] £m | Earnings per share 2012 (restated)[1,2] pence |
|---|---|---|---|---|---|---|
| Adjusted earnings | **2,015** | **54.0** | 1,913 | 51.4 | 1,709 | 46.0 |
| Exceptional items after tax | **388** | **10.4** | 75 | 2.0 | 174 | 4.7 |
| Remeasurements after tax | **73** | **2.0** | 156 | 4.2 | (122) | (3.3) |
| Stranded cost recoveries after tax | **–** | **–** | 9 | 0.2 | 156 | 4.2 |
| Earnings | **2,476** | **66.4** | 2,153 | 57.8 | 1,917 | 51.6 |

| | 2014 millions | 2013 millions | 2012 millions |
|---|---|---|---|
| Weighted average number of shares – basic[2] | **3,729** | 3,724 | 3,719 |

1. See note 1 on page 92.
2. Comparative amounts have been restated to reflect the impact of additional shares issued as scrip dividends.

### (b) Diluted earnings per share

| | Earnings 2014 £m | Earnings per share 2014 pence | Earnings 2013 (restated)[1] £m | Earnings per share 2013 (restated)[1,2] pence | Earnings 2012 (restated)[1] £m | Earnings per share 2012 (restated)[1,2] pence |
|---|---|---|---|---|---|---|
| Adjusted earnings | **2,015** | **53.8** | 1,913 | 51.1 | 1,709 | 45.7 |
| Exceptional items after tax | **388** | **10.4** | 75 | 2.0 | 174 | 4.7 |
| Remeasurements after tax | **73** | **1.9** | 156 | 4.2 | (122) | (3.3) |
| Stranded cost recoveries after tax | **–** | **–** | 9 | 0.2 | 156 | 4.2 |
| Earnings | **2,476** | **66.1** | 2,153 | 57.5 | 1,917 | 51.3 |

| | 2014 millions | 2013 millions | 2012 millions |
|---|---|---|---|
| Weighted average number of shares – diluted[2] | **3,748** | 3,742 | 3,738 |

1. See note 1 on page 92.
2. Comparative amounts have been restated to reflect the impact of additional shares issued as scrip dividends.

### (c) Reconciliation of basic to diluted average number of shares

| | 2014 millions | 2013 millions | 2012 millions |
|---|---|---|---|
| Weighted average number of ordinary shares – basic | **3,729** | 3,724 | 3,719 |
| Effect of dilutive potential ordinary shares – employee share plans | **19** | 18 | 19 |
| Weighted average number of ordinary shares – diluted | **3,748** | 3,742 | 3,738 |

# Notes to the consolidated financial statements continued

## 8. Dividends

Dividends represents 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 pay out the remainder in accordance with 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.

The following table shows the actual dividends paid to equity shareholders:

| | **2014** | | | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Pence per share** | **Total £m** | **Settled via scrip £m** | Pence per share | Total £m | Settled via scrip £m | Pence per share | Total £m | Settled via scrip £m |
| Interim – year ended 31 March 2014 | **14.49** | **539** | **–** | – | – | – | – | – | – |
| Final – year ended 31 March 2013 | **26.36** | **964** | **444** | – | – | – | – | – | – |
| Interim – year ended 31 March 2013 | **–** | **–** | **–** | 14.49 | 527 | 187 | – | – | – |
| Final – year ended 31 March 2012 | **–** | **–** | **–** | 25.35 | 906 | 436 | – | – | – |
| Interim – year ended 31 March 2012 | **–** | **–** | **–** | – | – | – | 13.93 | 497 | 34 |
| Final – year ended 31 March 2011 | **–** | **–** | **–** | – | – | – | 23.47 | 822 | 279 |
| | **40.85** | **1,503** | **444** | 39.84 | 1,433 | 623 | 37.40 | 1,319 | 313 |

The Directors are proposing a final dividend for the year ended 31 March 2014 of 27.54p per share that will absorb approximately £1,028m of shareholders' equity (assuming all amounts are settled in cash). It will be paid on 20 August 2014 to shareholders who are on the register of members at 6 June 2014 and a scrip dividend will be offered as an alternative, subject to shareholders' approval at the AGM.

### Unaudited commentary on dividends

Following the announcement of our new dividend policy in March 2013, we remain confident that our business is able to support a dividend rising at least in line with inflation for the foreseeable future, while continuing to invest as required in our regulated asset bases. The dividend cover chart opposite supports our decision.

With the exception of the 2013/14 interim dividend paid in January this year, a scrip option has been offered for all interim and final dividends in the last three years. The scrip take-up was as follows: 2012/13 final: 46%; 2012/13 interim: 35%; and 2011/12 final: 48%.

**Dividend cover**
Times


**This unaudited commentary does not form part of the financial statements.**

## 9. Goodwill

Goodwill represents the excess of what we paid to acquire businesses over the fair value of their net assets at the acquisition date. We assess whether goodwill is recoverable each year by performing an impairment review.

Goodwill is recognised as an asset and is not amortised, but is tested for impairment annually, or more frequently if events or changes in circumstances indicate a potential impairment. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing exchange rate.

### Impairment

Goodwill is allocated to cash-generating units and this allocation is made to those cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

Impairments of goodwill are calculated as the difference between the carrying value of the goodwill and the estimated recoverable amount of the cash-generating unit to which that goodwill has been allocated. Recoverable amount is defined as the higher of fair value less costs to sell and estimated value-in-use at the date the impairment review is undertaken.

Value-in-use represents the present value of expected future cash flows, discounted using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

Impairments are recognised in the income statement and are disclosed separately.

| | Total £m |
|---|---|
| Cost at 1 April 2012 | 4,776 |
| Exchange adjustments | 252 |
| Cost at 31 March 2013 | 5,028 |
| Additions | 12 |
| Exchange adjustments | (446) |
| Cost at 31 March 2014 | 4,594 |
| **Net book value at 31 March 2014** | **4,594** |
| Net book value at 31 March 2013 | 5,028 |

The amounts disclosed above as at 31 March 2014 include balances relating to the following cash-generating units: New York £2,640m (2013: £2,898m); Massachusetts £987m (2013: £1,082m); Rhode Island £367m (2013: £403m); and Federal £600m (2013: £645m).

Additions during the year relate to a further investment in Clean Line Energy Partners LLC, a developer of long-distance, HVDC transmission projects in the US to move renewable energy to market. Under IFRS 10, this investment is now accounted for as a subsidiary rather than an equity investment. National Grid has a 37% interest, but has the option to increase this holding.

Goodwill is reviewed annually for impairment and the recoverability of goodwill at 31 March 2014 has been assessed by comparing the carrying amount of our operations described above (our cash-generating units) with the expected recoverable amount on a value-in-use basis. In each assessment, the value-in-use has been calculated based on five year plan projections that incorporate our best estimates of future cash flows, customer rates, costs, future prices and growth. Such projections reflect our current regulatory rate plans taking into account regulatory arrangements to allow for future rate plan filings and recovery of investment. Our plans have proved to be reliable guides in the past and the Directors believe the estimates are appropriate.

The future growth rate used to extrapolate projections beyond five years has been maintained at 2.25% (2013: 2.25%). The growth rate has been determined having regard to data on projected growth in US real gross domestic product (GDP). Based on our business' place in the underlying US economy, it is appropriate for the terminal growth rate to be based upon the overall growth in real GDP and, given the nature of our operations, to extend over a long period of time. Cash flow projections have been discounted to reflect the time value of money, using an effective pre-tax discount rate of 9% (2013: 9%). The discount rate represents the estimated weighted average cost of capital of these operations.

While it is possible that a key assumption in the calculation could change, the Directors believe that no reasonably foreseeable change would result in an impairment of goodwill, in view of the long-term nature of the key assumptions and the margin by which the estimated fair value exceeds the carrying amount.

# Notes to the consolidated financial statements continued

## 10. Other intangible assets

Other intangible assets includes software and acquisition-related assets (such as brand names and customer relationships), which are 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. Other intangible assets are tested for impairment only if there is an 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 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.

On a business combination, as well as recording separable intangible assets possessed by the acquired entity at their fair value, identifiable intangible assets that arise from contractual or other legal rights are also included in the statement of financial position at their fair value. Acquisition-related intangible assets principally comprise customer relationships.

Other intangible assets are amortised on a straight-line basis over their estimated useful economic lives. Amortisation periods for categories of intangible assets are:

| | Years |
|---|---|
| Software | 3 to 10 |
| Acquisition-related intangibles | 10 to 25 |

| | Software £m | Acquisition-related £m | Total £m |
|---|---|---|---|
| Cost at 1 April 2012 | 899 | 116 | 1,015 |
| Exchange adjustments | 20 | 6 | 26 |
| Additions | 175 | – | 175 |
| Disposals | (26) | – | (26) |
| Reclassifications[1] | (37) | – | (37) |
| Cost at 31 March 2013 | 1,031 | 122 | 1,153 |
| Exchange adjustments | (38) | (7) | (45) |
| Additions | 179 | – | 179 |
| Disposals | (16) | (115) | (131) |
| Reclassifications[1] | 66 | – | 66 |
| Cost at 31 March 2014 | 1,222 | – | 1,222 |
| Accumulated amortisation at 1 April 2012 | (353) | (116) | (469) |
| Exchange adjustments | (6) | (6) | (12) |
| Amortisation charge for the year | (101) | – | (101) |
| Disposals | 9 | – | 9 |
| Reclassifications[1] | 9 | – | 9 |
| Accumulated amortisation at 31 March 2013 | (442) | (122) | (564) |
| Exchange adjustments | 12 | 7 | 19 |
| Amortisation charge for the year | (127) | – | (127) |
| Impairment charge | (5) | – | (5) |
| Disposals | 12 | 115 | 127 |
| Reclassifications[1] | (3) | – | (3) |
| Accumulated amortisation at 31 March 2014 | (553) | – | (553) |
| **Net book value at 31 March 2014** | **669** | **–** | **669** |
| Net book value at 31 March 2013 | 589 | – | 589 |

1. Reclassifications represents amounts transferred (to)/from property, plant and equipment (see note 11 on page 112).

## 11. 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. 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.

### Our strategy in action

We operate an energy networks business and therefore have a significant physical asset base. We continue to invest in our networks to maintain reliability, create new customer connections and ensure our networks are flexible and resilient. Our business plan envisages these additional investments will be funded through a mixture of cash generated from operations and the issue of new debt.

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 Company'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.

Contributions received prior to 1 July 2009 towards the cost of property, plant and equipment are included in trade and other payables as deferred income and credited on a straight-line basis to the income statement over the estimated useful economic lives of the assets to which they relate.

Contributions received post 1 July 2009 are recognised in revenue immediately, except where the contributions are consideration for a future service, in which case they are recognised initially as deferred income, and revenue is subsequently recognised over the period in which the service is provided.

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. 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 | up to 65 |
| Plant and machinery | |
| Electricity transmission plant | 15 to 60 |
| Electricity distribution plant | 15 to 60 |
| Electricity generation plant | 20 to 40 |
| Interconnector plant | 15 to 60 |
| Gas plant – mains, services and regulating equipment | 30 to 100 |
| Gas plant – storage | 15 to 21 |
| Gas plant – meters | 10 to 33 |
| Motor vehicles and office equipment | up to 10 |

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are, depending on their magnitude, recognised as an exceptional item 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.

Material 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.

# Notes to the consolidated financial statements continued

## 11. Property, plant and equipment continued

| | 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 1 April 2012 | 2,013 | 42,699 | 2,975 | 770 | 48,457 |
| Exchange adjustments | 55 | 803 | 45 | 13 | 916 |
| Additions | 141 | 704 | 2,584 | 82 | 3,511 |
| Disposals | (24) | (311) | (2) | (130) | (467) |
| Reclassifications[1] | 140 | 1,471 | (1,642) | 68 | 37 |
| Cost at 31 March 2013 | 2,325 | 45,366 | 3,960 | 803 | 52,454 |
| Exchange adjustments | (99) | (1,471) | (82) | (28) | (1,680) |
| Additions | 69 | 623 | 2,514 | 56 | 3,262 |
| Disposals | (32) | (288) | (2) | (98) | (420) |
| Reclassifications[1] | (15) | 2,195 | (2,366) | 120 | (66) |
| Cost at 31 March 2014 | 2,248 | 46,425 | 4,024 | 853 | 53,550 |
| Accumulated depreciation at 1 April 2012 | (436) | (13,804) | (2) | (514) | (14,756) |
| Exchange adjustments | (11) | (216) | – | (9) | (236) |
| Depreciation charge for the year[2] | (75) | (1,085) | – | (121) | (1,281) |
| Disposals | 23 | 299 | 2 | 96 | 420 |
| Reclassifications[1] | – | – | – | (9) | (9) |
| Accumulated depreciation at 31 March 2013 | (499) | (14,806) | – | (557) | (15,862) |
| Exchange adjustments | 16 | 399 | – | 21 | 436 |
| Depreciation charge for the year[2] | (84) | (1,112) | – | (103) | (1,299) |
| Impairment charge for the year | (1) | – | – | – | (1) |
| Disposals | 25 | 234 | – | 93 | 352 |
| Reclassifications[1] | 107 | (65) | – | (39) | 3 |
| Accumulated depreciation at 31 March 2014 | (436) | (15,350) | – | (585) | (16,371) |
| **Net book value at 31 March 2014** | **1,812** | **31,075** | **4,024** | **268** | **37,179** |
| Net book value at 31 March 2013 | 1,826 | 30,560 | 3,960 | 246 | 36,592 |

1. Represents amounts transferred between categories and from/(to) other intangible assets (see note 10 on page 110).
2. Includes amounts in respect of capitalised depreciation of £10m (2013: £21m).

| | **2014 £m** | 2013 £m |
|---|---|---|
| **Information in relation to property, plant and equipment** | | |
| Capitalised interest included within cost | **1,409** | 1,275 |
| Net book value of assets held under finance leases (all relating to motor vehicles and office equipment) | **170** | 188 |
| Additions to assets held under finance leases (all relating to motor vehicles and office equipment) | **25** | 48 |
| Contributions to cost of property, plant and equipment included within: | | |
| Trade and other payables | **44** | 43 |
| Non-current liabilities | **1,526** | 1,492 |

## 12. Other non-current assets

Other non-current assets includes assets that do not fall into any other non-current asset category (such as goodwill or property, plant and equipment) and where the benefit to be received from the asset is not due to be received until after 31 March 2015.

| | **2014 £m** | 2013 £m |
|---|---|---|
| Commodity contract assets | **45** | 47 |
| Other receivables | **33** | 51 |
| Prepayments | **9** | 6 |
| | **87** | 104 |

## 13. Financial and other investments

Financial and other investments includes two main categories. Assets classified as available-for-sale typically represent investments in short-term money funds and quoted investments in equities or bonds of other companies. The second category is loans and receivables which includes bank deposits with a maturity of greater than three months, and cash balances that cannot be readily used in operations, principally collateral pledged for certain borrowings and restricted cash balances relating to our UK pension schemes.

Financial assets, liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into, and recognised on trade date. Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any other categories.

Available-for-sale financial investments are recognised at fair value plus directly related incremental transaction costs, and are subsequently carried at fair value in the statement of financial position. Changes in the fair value of available-for-sale investments are recognised directly in equity, until the investment is disposed of or is determined to be impaired. At this time the cumulative gain or loss previously recognised in equity is included in the income statement for the period. Investment income is recognised using the effective interest method and taken through interest income in the income statement.

Loans receivable and other receivables are initially recognised at fair value and subsequently held at amortised cost using the effective interest method. Interest income, together with gains and losses when the loans and receivables are derecognised or impaired, are recognised in the income statement.

Subsequent to initial recognition, the fair values of financial assets measured at fair value that are quoted in active markets are based on bid prices. When independent prices are not available, fair values are determined by using valuation techniques that are consistent with techniques commonly used by the relevant market. The techniques use observable market data.

| | 2014 £m | 2013 £m |
|---|---|---|
| **Non-current** | | |
| Available-for-sale investments | **284** | 278 |
| **Current** | | |
| Available-for-sale investments | **2,716** | 4,441 |
| Loans and receivables | **883** | 990 |
| | **3,599** | 5,431 |
| **Total financial and other investments** | **3,883** | 5,709 |
| Financial and other investments include the following: | | |
| Investments in short-term money funds | **2,165** | 4,120 |
| Managed investments in equity and bonds[1] | **465** | 453 |
| Bank deposits[1] | **355** | 165 |
| Cash surrender value of life insurance policies | **140** | 145 |
| Other investments | **2** | 4 |
| Restricted balances[2] | **756** | 822 |
| | **3,883** | 5,709 |

1. Includes £296m (2013: £296m) of current investments which are held by insurance captives and are therefore restricted.
2. Principally comprises collateral placed with counterparties with whom we have entered into a credit support annex to the ISDA Master Agreement £402m (2013: £507m), and assets held within security accounts, with charges in favour of the UK pension schemes Trustees of £234m (2013: £179m).

Available-for-sale investments are recorded at fair value. Due to their short maturities the carrying value of loans and receivables approximates their fair value. The maximum exposure to credit risk at the reporting date is the fair value of the financial investments. For further information on our credit risk, refer to note 30 (a). None of the financial investments are past due or impaired.

# Notes to the consolidated financial statements continued

## 14. Investments in joint ventures and associates

Investments in joint ventures and associates represents businesses we do not control, but instead exercise joint control or significant influence.

A joint venture is an arrangement established to engage in economic activity, which the Company jointly controls with other parties and has rights to the net assets of the arrangement. An associate is an entity that is neither a subsidiary nor a joint venture, but over which the Company has significant influence.

| | 2014 £m | 2013 £m |
|---|---|---|
| Share of net assets at 1 April | 371 | 341 |
| Exchange adjustments | (16) | 9 |
| Additions | 4 | 14 |
| Share of post-tax results for the year | 28 | 18 |
| Dividends received | (38) | (21) |
| Other movements | 2 | 10 |
| **Share of net assets at 31 March** | **351** | 371 |

A list of principal joint ventures and associates including the name, proportion of ownership and principal activity is provided in note 32.

The joint ventures and associates have no significant contingent liabilities to which the Group is exposed, and the Group has no significant contingent liabilities in relation to its interest in the joint ventures and associates.

Outstanding balances with joint ventures and associates are shown in note 28.

## 15. Derivative financial instruments

Derivatives are financial instruments that derive their value from the price of an underlying item such as interest rates, foreign exchange, credit spreads, commodities, equity or other indices. In accordance with Board approved policies, derivatives are transacted to manage our exposure to fluctuations in interest rate and foreign exchange rate on borrowings and other contractual cash flows. Specifically, we use derivatives to manage these risks from our financing portfolio to optimise the overall cost of accessing the debt capital markets. These derivatives are analysed below. We also use derivatives to manage our operational market risks from commodities. The commodity derivative contracts are detailed in note 30 (e).

Derivative financial instruments are initially recognised at fair value and subsequently remeasured at fair value at each reporting date. Changes in fair values are recorded in the period they arise, either in the income statement or other comprehensive income depending on the applicable accounting standards. Where the fair value of a derivative is positive it is carried as a derivative asset, and where negative as a derivative liability.

We calculate fair value of the financial derivatives by discounting all future cash flows using the market yield curve at the reporting date. The market yield curve for each currency is obtained from external sources for interest and foreign exchange rates. In the absence of sufficient market data, fair values would be based on the quoted market price of similar derivatives. Analysis of these derivatives and the various methods used to calculate their respective fair values is detailed below and in note 30.

For each class of derivative instrument type the fair value amounts are as follows:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Assets £m | Liabilities £m | Total £m | Assets £m | Liabilities £m | Total £m |
| Interest rate swaps | 861 | (743) | 118 | 1,282 | (1,207) | 75 |
| Cross-currency interest rate swaps | 1,025 | (195) | 830 | 900 | (160) | 740 |
| Foreign exchange forward contracts | 68 | (12) | 56 | 15 | (63) | (48) |
| Forward rate agreements | – | – | – | – | (5) | (5) |
| Inflation linked swaps | 16 | (213) | (197) | 48 | (246) | (198) |
| **Total** | **1,970** | **(1,163)** | **807** | 2,245 | (1,681) | 564 |

## 15. Derivative financial instruments continued

The maturity profile of derivative financial instruments is as follows:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Assets £m | Liabilities £m | Total £m | Assets £m | Liabilities £m | Total £m |
| Less than 1 year | 413 | (339) | 74 | 273 | (407) | (134) |
| **Current** | 413 | (339) | 74 | 273 | (407) | (134) |
| In 1-2 years | 54 | (26) | 28 | 42 | (44) | (2) |
| In 2-3 years | 73 | (57) | 16 | 75 | (51) | 24 |
| In 3-4 years | 71 | (103) | (32) | 119 | (121) | (2) |
| In 4-5 years | 244 | (128) | 116 | 84 | (55) | 29 |
| More than 5 years | 1,115 | (510) | 605 | 1,652 | (1,003) | 649 |
| **Non-current** | 1,557 | (824) | 733 | 1,972 | (1,274) | 698 |
| | 1,970 | (1,163) | 807 | 2,245 | (1,681) | 564 |

For each class of derivative the notional contract* amounts are as follows:

| | 2014 £m | 2013 £m |
|---|---|---|
| Interest rate swaps | (15,406) | (16,603) |
| Cross-currency interest rate swaps | (8,614) | (9,641) |
| Foreign exchange forward contracts | (4,698) | (3,142) |
| Forward rate agreements | – | (2,443) |
| Inflation linked swaps | (1,391) | (1,390) |
| **Total** | (30,109) | (33,219) |

*The notional contract amounts of derivatives indicate the gross nominal value of transactions outstanding at the reporting date.

Where possible, derivatives held as hedging instruments are formally designated as hedges as defined in IAS 39. Derivatives may qualify as hedges for accounting purposes if they are fair value hedges, cash flow hedges or net investment hedges. Our use of derivatives may entail a derivative transaction qualifying for one or more hedge type designations under IAS 39.

Hedge accounting allows derivatives to be designated as a hedge of another non-derivative financial instrument, to mitigate the impact of potential volatility in the income statement of changes in the fair value of the derivative financial instruments. To qualify for hedge accounting, documentation is prepared specifying the hedging strategy, the component transactions and methodology used for effectiveness measurement. National Grid uses three hedge accounting methods, which are described as follows:

### Fair value hedges

Fair value hedges principally consist of interest rate and cross-currency swaps that are used to protect against changes in the fair value of fixed-rate, long-term financial instruments due to movements in market interest rates. For qualifying fair value hedges, all changes in the fair value of the derivative and changes in the fair value of the item in relation to the risk being hedged are recognised in the income statement to the extent the fair value hedge is effective. Adjustments made to the carrying amount of the hedged item for fair value hedges will be amortised over the remaining life, in line with the hedged item.

| | 2014 £m | 2013 £m |
|---|---|---|
| Cross-currency interest rate/interest rate swaps | 367 | 732 |
| **Fair value hedges** | 367 | 732 |

### Cash flow hedges

Exposure arises from the variability in future interest and currency cash flows on assets and liabilities which bear interest at variable rates or are in a foreign currency. Interest rate and cross-currency swaps are maintained, and designated as cash flow hedges, where they qualify, to manage this exposure. Fair value changes on designated cash flow hedges are initially recognised directly in the cash flow hedge reserve, as gains or losses recognised in equity and any ineffective portion is recognised immediately in the income statement. Amounts are transferred from equity and recognised in the income statement as the income or expense is recognised on the hedged item.

Forward foreign currency contracts are used to hedge anticipated and committed future currency cash flows. Where these contracts qualify for hedge accounting they are designated as cash flow hedges. On recognition of the underlying transaction in the financial statements, the associated hedge gains and losses, deferred in equity, are transferred and included with the recognition of the underlying transaction.

# Notes to the consolidated financial statements continued

## 15. Derivative financial instruments continued

**Cash flow hedges** continued

When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is transferred to the income statement.

Where a non-financial asset or a non-financial liability results from a forecasted transaction or firm commitment being hedged, the amounts deferred in equity are included in the initial measurement of that non-monetary asset or liability.

| | 2014 £m | 2013 £m |
|---|---|---|
| Cross-currency interest rate/interest rate swaps | 224 | 123 |
| Foreign exchange forward contracts | (11) | 1 |
| Inflation linked swaps | (32) | (16) |
| **Cash flow hedges** | **181** | 108 |

**Net investment hedges**

Borrowings, cross-currency swaps and forward currency contracts are used in the management of the foreign exchange exposure arising from the investment in non-sterling denominated subsidiaries. Where these contracts qualify for hedge accounting they are designated as net investment hedges.

| | 2014 £m | 2013 £m |
|---|---|---|
| Cross-currency interest rate swaps | 342 | (56) |
| Foreign exchange forward contracts | 66 | (39) |
| **Net investment hedges** | **408** | (95) |

The cross-currency swaps and forward foreign currency contracts are hedge accounted using the spot to spot method. The foreign exchange gain or loss on retranslation of the borrowings and the spot to spot movements on the cross-currency swaps and forward currency contracts are transferred to equity to offset gains or losses on translation of the net investment in the non-sterling denominated subsidiaries, with any ineffective portion recognised immediately in the income statement.

**Derivatives not in a formal hedge relationship**

Our policy is not to use derivatives for trading purposes. However, due to the complex nature of hedge accounting under IAS 39 some derivatives may not qualify for hedge accounting, or are specifically not designated as a hedge where natural offset is more appropriate. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised in remeasurements within the income statement.

| | 2014 £m | 2013 £m |
|---|---|---|
| Cross-currency interest rate/interest rate swaps | 15 | 16 |
| Foreign exchange forward contracts | 1 | (10) |
| Forward rate agreements | – | (5) |
| Inflation linked swaps | (165) | (182) |
| **Derivatives not in a formal hedge relationship** | **(149)** | (181) |

**Discontinuation of hedge accounting**

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, exercised or no longer qualifies for hedge accounting. At that time, any cumulative gains or losses relating to cash flow hedges recognised in equity are initially retained in equity and subsequently recognised in the income statement in the same periods in which the previously hedged item affects net profit or loss. Amounts deferred in equity with respect to net investment hedges are subsequently recognised in the income statement in the event of the disposal of the overseas operations concerned. For fair value hedges, the cumulative adjustment recorded to the carrying value of the hedged item at the date hedge accounting is discontinued is amortised to the income statement using the effective interest method.

**Embedded derivatives**

No adjustment is made with respect to derivative clauses embedded in financial instruments or other contracts that are defined as closely related to those instruments or contracts. Consequently these embedded derivatives are not accounted for separately from the debt instrument. Where there are embedded derivatives in host contracts not closely related, the embedded derivative is separately accounted for as a derivative financial instrument.

## 16. Inventories and current intangible assets

Inventories represent assets that we intend to use in order to generate revenue in the short term, either by selling the asset itself (for example fuel stocks) or by using it to fulfil a service to a customer or to maintain our network (consumables).

Inventories are stated at the lower of weighted average cost and net realisable value.

Where applicable, cost comprises direct materials and direct labour costs as well as those overheads that have been incurred in bringing the inventories to their present location and condition.

Emission allowances, principally relating to the emissions of carbon dioxide in the UK and sulphur and nitrous oxides in the US, are recorded as intangible assets within current assets and are initially recorded at cost and subsequently at the lower of cost and net realisable value. Where emission allowances are granted by relevant authorities, cost is deemed to be equal to the fair value at the date of allocation. Receipts of such grants are treated as deferred income, which is recognised in the income statement as the related charges for emissions are recognised or on impairment of the related intangible asset. A provision is recorded in respect of the obligation to deliver emission allowances and emission charges are recognised in the income statement in the period in which emissions are made.

| | 2014 £m | 2013 £m |
|---|---|---|
| Fuel stocks | **74** | 114 |
| Raw materials and consumables | **128** | 156 |
| Work in progress | **13** | 13 |
| Current intangible assets – emission allowances | **53** | 8 |
| | **268** | 291 |

There is a provision for obsolescence of £29m against inventories as at 31 March 2014 (2013: £27m).

# Notes to the consolidated financial statements continued

## 17. Trade and other receivables

Trade and other receivables are amounts which are due from our customers for services (and commodities in the US) we have provided. Other receivables also include prepayments made by us, for example, property lease rentals paid in advance.

Trade, loan and other receivables are initially recognised at fair value and subsequently measured at amortised cost, less any appropriate allowances for estimated irrecoverable amounts. A provision is established for irrecoverable amounts when there is objective evidence that amounts due under the original payment terms will not be collected.

| | 2014 £m | 2013 £m |
|---|---|---|
| Trade receivables | **1,602** | 1,325 |
| Prepayments and accrued income | **1,090** | 1,421 |
| Commodity contract assets | **42** | 42 |
| Current tax assets | **11** | – |
| Other receivables | **110** | 122 |
| | **2,855** | 2,910 |

Trade receivables are non interest-bearing and generally have a 30-90 day term. Due to their short maturities, the fair value of trade and other receivables approximates their book value. Commodity contract assets are recorded at fair value. All other receivables are recorded at amortised cost.

### Provision for impairment of receivables

| | 2014 £m | 2013 £m |
|---|---|---|
| At 1 April | **261** | 270 |
| Exchange adjustments | **(23)** | 13 |
| Charge for the year, net of recoveries | **105** | 75 |
| Uncollectible amounts written off against receivables | **(94)** | (97) |
| At 31 March | **249** | 261 |

### Trade receivables past due but not impaired

| | 2014 £m | 2013 £m |
|---|---|---|
| Up to 3 months past due | **212** | 242 |
| 3 to 6 months past due | **69** | 45 |
| Over 6 months past due | **65** | 4 |
| | **346** | 291 |

For further information on our wholesale and retail credit risk, refer to note 30 (a). For further information on our commodity risk, refer to note 30 (e).

## 18. Cash and cash equivalents

Cash and cash equivalents includes cash balances, together with short-term investments with a 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. For further information on currency exposures, refer to note 30 (d).

| | **2014 £m** | 2013 £m |
|---|---|---|
| Cash at bank | **75** | 99 |
| Short-term deposits | **279** | 572 |
| **Cash and cash equivalents excluding bank overdrafts** | **354** | 671 |
| Bank overdrafts | **(15)** | (23) |
| **Net cash and cash equivalents** | **339** | 648 |

At 31 March 2014, £24m (2013: £21m) of cash and cash equivalents were restricted. This primarily relates to cash held in captive insurance companies.

## 19. Borrowings

We borrow money primarily in the form of bonds and bank loans. These are for a fixed term and may have fixed or floating interest rates or are linked to RPI. As indicated in note 15, we use derivatives to manage risks associated with interest rates and foreign exchange.

### Our strategy in action

Our price controls and rate plans require us to fund our networks within a certain ratio of debt to equity and, as a result, we have issued a significant amount of debt. As we continue to invest in our networks, the level of debt is expected to increase over time. To maintain a strong balance sheet and to allow us to access capital markets at commercially acceptable interest rates, we balance the amount of debt we issue with the value of our assets and take account of certain other metrics used by credit rating agencies.

Borrowings, which include interest-bearing and inflation linked debt and overdrafts are recorded at their initial fair value which normally reflects the proceeds received, net of direct issue costs less any repayments. Subsequently these are stated at amortised cost, using the effective interest method. 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.

The Finance Committee controls refinancing risk by limiting the amount of our debt maturities arising from borrowings in any one year which is demonstrated by our maturity profile.

| | **2014 £m** | 2013 £m |
|---|---|---|
| **Current** | | |
| Bank loans | **1,485** | 1,194 |
| Bonds | **1,730** | 1,761 |
| Commercial paper | **252** | 438 |
| Finance leases | **19** | 20 |
| Other loans | **10** | 12 |
| Bank overdrafts | **15** | 23 |
| | **3,511** | 3,448 |
| **Non-current** | | |
| Bank loans | **1,414** | 1,863 |
| Bonds | **20,732** | 22,435 |
| Finance leases | **151** | 175 |
| Other loans | **142** | 174 |
| | **22,439** | 24,647 |
| **Total** | **25,950** | 28,095 |

# Notes to the consolidated financial statements continued

## 19. Borrowings continued

Total borrowings are repayable as follows:

| | 2014 £m | 2013 £m |
|---|---|---|
| Less than 1 year | **3,511** | 3,448 |
| In 1-2 years | **895** | 1,872 |
| In 2-3 years | **1,177** | 860 |
| In 3-4 years | **1,661** | 1,255 |
| In 4-5 years | **1,509** | 1,420 |
| More than 5 years: | | |
| by instalments | **175** | 71 |
| other than by instalments | **17,022** | 19,169 |
| | **25,950** | 28,095 |

The fair value of borrowings at 31 March 2014 was £28,131m (2013: £30,792m). Where market values were available, fair value of borrowings (Level 1) was £17,388m (2013: £20,543m). Where market values were not available, fair value of borrowings (Level 2) was £10,743m (2013: £10,249m), calculated by discounting cash flows at prevailing interest rates. The notional amount outstanding of the debt portfolio at 31 March 2014 was £25,539m (2013: £27,391m).

The assets of the Colonial Gas Company and the Niagara Mohawk Power Corporation and certain gas distribution assets of the Narragansett Electric Company are subject to liens and other charges and are provided as collateral over borrowings totalling £438m at 31 March 2014 (2013: £512m).

Collateral is placed with or received from any counterparty where we have entered into a credit support annex to the ISDA Master Agreement once the current mark-to-market valuation of the trades between the parties exceeds an agreed threshold. Included in current bank loans is £843m (2013: £730m) in respect of cash received under collateral agreements. For further details of our borrowing facilities, refer to note 31. For further details of our bonds in issue, please refer to the debt investor section of our website.

Assets held under finance leases are recognised at their fair value or, if lower, the present value of the minimum lease payments on inception. The corresponding liability is recognised as a finance lease obligation within borrowings. Rental payments are apportioned between finance costs and reduction in the finance lease obligation, so as to achieve a constant rate of interest.

Assets held under finance leases are depreciated over the shorter of their useful life and the lease term.

### Finance lease obligations

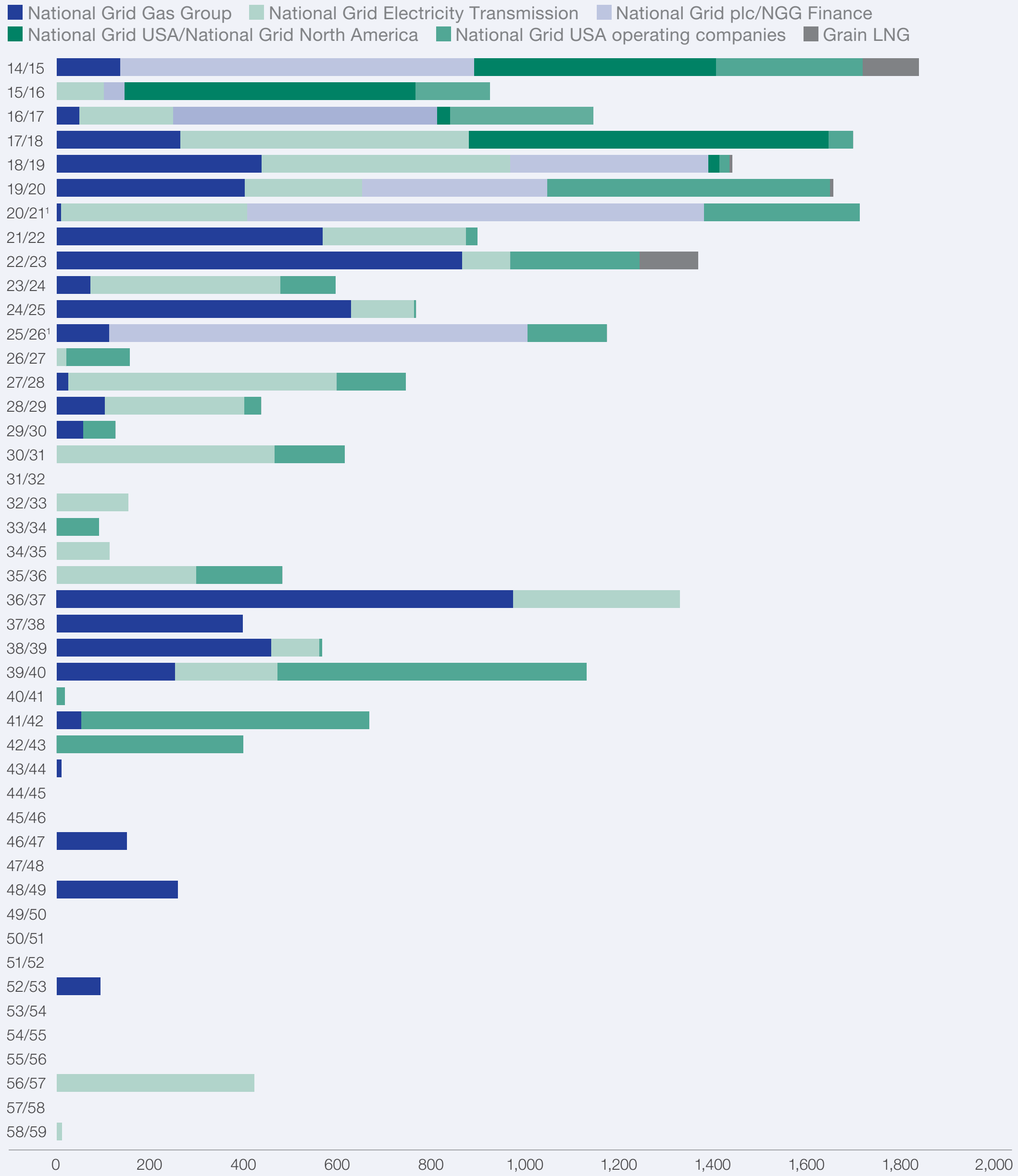
| | 2014 £m | 2013 £m |
|---|---|---|
| Gross finance lease liabilities are repayable as follows: | | |
| Less than 1 year | **19** | 20 |
| 1-5 years | **89** | 109 |
| More than 5 years | **100** | 101 |
| | **208** | 230 |
| Less: finance charges allocated to future periods | **(38)** | (35) |
| | **170** | 195 |
| The present value of finance lease liabilities is as follows: | | |
| Less than 1 year | **19** | 20 |
| 1-5 years | **70** | 96 |
| More than 5 years | **81** | 79 |
| | **170** | 195 |

## Unaudited commentary on borrowings

As at 31 March 2014, total borrowings of £25,950m (2013: £28,095m) including bonds, bank loans, commercial paper, collateral, finance leases and other debt had decreased by £2,145m primarily representing maturity and redemption of debt during the year. We expect to repay £3,511m of our total borrowings in the next 12 months including commercial paper, collateral and interest, and we expect to be able to refinance this borrowing through the capital and money markets.

The maturity profile of long-term debt in our major entities is illustrated below:

**National Grid long-term debt maturity profile**
£m




1. Includes hybrid bonds at first callable date (euro: 2020; sterling: 2025). Actual maturity of these bonds is euro: 2076; sterling: 2073.

Further information on our bonds can be found in the debt investor section of our website.

**This unaudited commentary does not form part of the financial statements.**

# Notes to the consolidated financial statements continued

## 20. Trade and other payables

Trade and other payables includes amounts owed to suppliers, tax authorities and other parties which are due to be settled within 12 months. The total also includes deferred income, which represents monies received from customers but for which we have not yet completed 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.

| | 2014 £m | 2013 £m |
|---|---|---|
| Trade payables | **1,942** | 2,033 |
| Deferred income | **224** | 155 |
| Commodity contract liabilities | **77** | 69 |
| Social security and other taxes | **146** | 131 |
| Other payables | **642** | 663 |
| | **3,031** | 3,051 |

Due to their short maturities, the fair value of trade and other payables approximates their book value. Commodity contract liabilities are recorded at fair value. All other trade and other payables are recorded at amortised cost.

## 21. Other non-current liabilities

Other non-current liabilities includes deferred income which will not be recognised as income until after 31 March 2015. It also includes payables that are not due until after that date.

| | 2014 £m | 2013 £m |
|---|---|---|
| Deferred income | **1,605** | 1,579 |
| Commodity contract liabilities | **46** | 70 |
| Other payables | **190** | 235 |
| | **1,841** | 1,884 |

Commodity contract liabilities are recorded at fair value. All other non-current liabilities are recorded at amortised cost. There is no material difference between the fair value and the carrying value of other non-current liabilities.

## 22. Pensions and other post-retirement benefits

Substantially all our employees are members of either DB or DC pension plans. The principal UK plans are the National Grid UK Pension Scheme, the National Grid Electricity Group of the Electricity Supply Pension Scheme and The National Grid YouPlan. In the US, we have a number of plans and also provide healthcare and life insurance benefits to eligible retired US employees.

The fair value of associated plan assets and present value of DB obligations are updated annually. For further details and the actuarial assumptions used to value the obligations, see note 29.

With the adoption of IAS 19 (revised), we have increased our disclosures by separately presenting our UK and US pension plans to show geographical split.

Below we provide a more detailed analysis of the amounts recorded in the primary financial statements.

For DC plans, the Group pays contributions into separate funds on behalf of the employee and has no further obligations to employees. The risks associated with this type of plan are assumed by the member.

For DB retirement plans, members receive benefits on retirement, the value of which is dependent on factors such as salary and length of pensionable service. The Group underwrites both financial and demographic risks associated with this type of plan.

The cost of providing benefits in a DB plan is determined using the projected unit method, with actuarial valuations being carried out at each reporting date by a qualified actuary. This valuation method is an accrued benefits valuation method that makes allowance for projected earnings.

The Group's obligation in respect of DB pension plans is calculated separately for each plan by projecting the estimated amount of future benefit payments that employees have earned for their pensionable service in the current and prior periods. These future benefit payments are discounted to determine the present value of the liabilities and the fair value of plan assets and any unrecognised past service cost is then deducted. The discount rate used is the yield at the valuation date on high-quality corporate bonds.

## 22. Pensions and other post-retirement benefits continued

The Group takes advice from independent actuaries relating to the appropriateness of any key assumptions applied which include life expectancy of members, expected salary and pension increases, and inflation. It should be noted that comparatively small changes in the assumptions used may have a significant effect on the amounts recognised in the income statement and the statement of other comprehensive income and the net liability recognised in the statement of financial position.

Remeasurements of net retirement obligations are recognised in full in the period in which they occur in the statement of other comprehensive income.

### Risks

The DB pension obligations and other post-retirement benefit liabilities are exposed to the primary risks outlined below.

Liabilities are calculated using discount rates set with reference to yields on high-quality corporate bonds prevailing in the US and UK debt markets and will fluctuate as yields change. Plan funds are invested in a variety of asset classes, principally: equities, government securities, corporate bonds and property. Consequently, actual returns will differ from the underlying discount rate adopted and therefore have an impact on the net balance sheet liability.

Changes in inflation will affect both current and future pension payments and are partially mitigated through investment in inflation matching assets and hedging instruments.

Longevity is also a key driver of liabilities and changes in expected mortality will have a direct impact on liabilities. The liabilities are, in aggregate, relatively mature which serves to mitigate this risk to some extent.

Each plan's investment strategy seeks to balance the level of investment return sought with the aim of reducing volatility and risk. In undertaking this approach reference is made both to the maturity of the liabilities and the funding level of that plan. A number of further strategies are employed to manage underlying risks, including liability matching asset strategies, diversification of asset portfolios, interest rate hedging and active management of foreign exchange exposure.

### Amounts recognised in the statement of financial position

| | UK pensions | | | US pensions | | | US other post-retirement benefits | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2014 £m** | 2013 (restated)[1] £m | 2012 (restated)[1] £m | **2014 £m** | 2013 (restated)[1] £m | 2012 (restated)[1] £m | **2014 £m** | 2013 (restated)[1] £m | 2012 (restated)[1] £m |
| Present value of funded obligations | **(18,100)** | (18,495) | (16,719) | **(4,566)** | (4,915) | (4,424) | **(2,680)** | (3,020) | (2,630) |
| Fair value of plan assets | **17,409** | 17,392 | 16,107 | **4,229** | 4,378 | 3,850 | **1,620** | 1,515 | 1,192 |
| | **(691)** | (1,103) | (612) | **(337)** | (537) | (574) | **(1,060)** | (1,505) | (1,438) |
| Present value of unfunded obligations | **(62)** | (66) | (56) | **(186)** | (200) | (187) | **–** | – | – |
| Other post-employment liabilities | **–** | – | – | **–** | (3) | (5) | **(75)** | (83) | (66) |
| Net defined benefit liability | **(753)** | (1,169) | (668) | **(523)** | (740) | (766) | **(1,135)** | (1,588) | (1,504) |
| Represented by: | | | | | | | | | |
| Liabilities | **(753)** | (1,169) | (668) | **(697)** | (935) | (921) | **(1,135)** | (1,588) | (1,504) |
| Assets | **–** | – | – | **174** | 195 | 155 | **–** | – | – |
| | **(753)** | (1,169) | (668) | **(523)** | (740) | (766) | **(1,135)** | (1,588) | (1,504) |

1. See note 1 on page 92.

# Notes to the consolidated financial statements continued

## 22. Pensions and other post-retirement benefits continued

### Amounts recognised in the income statement and the statement of other comprehensive income

| | UK pensions | | | US pensions | | | US other post-retirement benefits | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2014 £m | 2013 (restated)[1] £m | 2012 (restated)[1] £m | 2014 £m | 2013 (restated)[1] £m | 2012 (restated)[1] £m | 2014 £m | 2013 (restated)[1] £m | 2012 (restated)[1] £m |
| **Included within operating costs** | | | | | | | | | |
| Administration costs | **6** | 6 | 6 | **5** | 4 | 5 | **1** | 2 | 1 |
| **Included within payroll costs** | | | | | | | | | |
| Defined contribution scheme costs | **19** | 16 | 13 | **21** | 23 | 25 | **–** | – | – |
| Defined benefit scheme costs | | | | | | | | | |
| Current service cost | **96** | 90 | 84 | **85** | 87 | 75 | **44** | 43 | 37 |
| Past service cost – augmentations | **15** | 2 | 2 | **–** | – | – | **–** | – | – |
| Past service (credit)/cost – redundancies | **(19)** | (7) | (6) | **–** | – | 19 | **–** | – | 23 |
| Past service credit – plan amendments | **(11)** | – | – | **–** | – | – | **–** | – | – |
| Special termination benefit cost – redundancies | **39** | 20 | 19 | **–** | – | – | **–** | – | – |
| | **139** | 121 | 112 | **106** | 110 | 119 | **44** | 43 | 60 |
| **Included within exceptional items** | | | | | | | | | |
| LIPA MSA transition | **–** | – | – | **(16)** | – | – | **(198)** | – | – |
| Net (gain)/loss on disposal of businesses | **–** | – | (6) | **–** | 3 | – | **–** | 1 | – |
| | **–** | – | (6) | **(16)** | 3 | – | **(198)** | 1 | – |
| **Included within finance income and costs** | | | | | | | | | |
| Net interest cost | **47** | 31 | 1 | **27** | 34 | 26 | **54** | 70 | 76 |
| **Total included in income statement** | **192** | 158 | 113 | **122** | 151 | 150 | **(99)** | 116 | 137 |
| Remeasurements of net retirement benefit obligations | **354** | (560) | (676) | **81** | (35) | (367) | **50** | (119) | (97) |
| Exchange adjustments | **–** | – | – | **60** | (37) | (2) | **126** | (75) | (6) |
| **Total included in the statement of other comprehensive income** | **354** | (560) | (676) | **141** | (72) | (369) | **176** | (194) | (103) |

1. See note 1 on page 92.

### Reconciliation of the net defined benefit liability

| | UK pensions | | | US pensions | | | US other post-retirement benefits | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2014 £m | 2013 (restated)[1] £m | 2012 (restated)[1] £m | 2014 £m | 2013 (restated)[1] £m | 2012 (restated)[1] £m | 2014 £m | 2013 (restated)[1] £m | 2012 (restated)[1] £m |
| Opening net defined benefit liability | **(1,169)** | (668) | (90) | **(740)** | (766) | (484) | **(1,588)** | (1,504) | (1,452) |
| (Cost)/credit recognised in the income statement | **(173)** | (142) | (100) | **(101)** | (128) | (125) | **99** | (116) | (137) |
| Remeasurement effects recognised in the statement of other comprehensive income | **354** | (560) | (676) | **141** | (72) | (369) | **176** | (194) | (103) |
| Employer contributions | **235** | 201 | 198 | **174** | 224 | 217 | **187** | 262 | 198 |
| Other movements | **–** | – | – | **3** | 2 | (5) | **(9)** | (36) | (10) |
| **Closing net defined benefit liability** | **(753)** | (1,169) | (668) | **(523)** | (740) | (766) | **(1,135)** | (1,588) | (1,504) |

1. See note 1 on page 92.

## 22. Pensions and other post-retirement benefits continued

| | UK pensions | | | US pensions | | | US other post-retirement benefits | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2014 £m** | 2013 (restated)[1] £m | 2012 (restated)[1] £m | **2014 £m** | 2013 (restated)[1] £m | 2012 (restated)[1] £m | **2014 £m** | 2013 (restated)[1] £m | 2012 (restated)[1] £m |
| **Changes in the present value of defined benefit obligations (including unfunded obligations)** | | | | | | | | | |
| Opening defined benefit obligations | **(18,561)** | (16,775) | (15,443) | **(5,115)** | (4,611) | (4,037) | **(3,020)** | (2,630) | (2,458) |
| Current service cost | **(96)** | (90) | (84) | **(85)** | (87) | (75) | **(44)** | (43) | (37) |
| Interest cost | **(780)** | (788) | (830) | **(221)** | (232) | (233) | **(123)** | (133) | (140) |
| Actuarial gains/(losses) – experience | **16** | 74 | (112) | **(22)** | 1 | (13) | **47** | 60 | 71 |
| Actuarial losses – demographic assumptions | **–** | – | – | **(129)** | 5 | (64) | **(154)** | (18) | (84) |
| Actuarial gains/(losses) – financial assumptions | **436** | (1,765) | (1,062) | **57** | (245) | (422) | **49** | (218) | (70) |
| Past service credit/(cost) – redundancies | **19** | 7 | 6 | **16** | 36 | (19) | **119** | 5 | (23) |
| Special termination benefit cost – redundancies | **(39)** | (20) | (13) | **–** | – | – | **–** | – | – |
| Past service cost – augmentations | **(15)** | (2) | (2) | **–** | – | – | **–** | – | – |
| Past service credit – plan amendments | **11** | – | – | **–** | – | – | **19** | – | – |
| Transfers in | **–** | – | 1 | **–** | – | – | **–** | – | – |
| Medicare subsidy received | **–** | – | – | **–** | – | – | **(17)** | (19) | (6) |
| Liabilities extinguished on settlements | **–** | – | – | **–** | – | – | **60** | – | – |
| Employee contributions | **(2)** | (3) | (3) | **–** | – | – | **–** | – | – |
| Benefits paid | **849** | 801 | 767 | **291** | 269 | 268 | **117** | 123 | 127 |
| Transferred to liabilities of businesses held for sale | **–** | – | – | **–** | – | 3 | **–** | – | 2 |
| Exchange adjustments | **–** | – | – | **456** | (251) | (19) | **267** | (147) | (12) |
| **Closing defined benefit obligations** | **(18,162)** | (18,561) | (16,775) | **(4,752)** | (5,115) | (4,611) | **(2,680)** | (3,020) | (2,630) |
| **Changes in the fair value of plan assets** | | | | | | | | | |
| Opening fair value of plan assets | **17,392** | 16,107 | 15,353 | **4,378** | 3,850 | 3,550 | **1,515** | 1,192 | 1,066 |
| Interest income | **733** | 757 | 829 | **194** | 198 | 207 | **69** | 63 | 64 |
| Return on assets (less)/greater than assumed | **(98)** | 1,131 | 498 | **175** | 204 | 132 | **108** | 57 | (14) |
| Administration costs | **(6)** | (6) | (6) | **(5)** | (4) | (5) | **(1)** | (2) | (1) |
| Transfers out | **–** | – | (1) | **–** | – | – | **–** | – | – |
| Employer contributions | **235** | 201 | 198 | **174** | 224 | 217 | **187** | 262 | 198 |
| Employee contributions | **2** | 3 | 3 | **–** | – | – | **–** | – | – |
| Benefits paid | **(849)** | (801) | (767) | **(291)** | (269) | (268) | **(117)** | (123) | (127) |
| Assets distributed in settlements and transfers | **–** | – | – | **–** | (39) | – | **–** | (6) | – |
| Exchange adjustments | **–** | – | – | **(396)** | 214 | 17 | **(141)** | 72 | 6 |
| **Closing fair value of plan assets** | **17,409** | 17,392 | 16,107 | **4,229** | 4,378 | 3,850 | **1,620** | 1,515 | 1,192 |
| **Actual return on plan assets** | **635** | 1,888 | 1,327 | **369** | 402 | 339 | **177** | 120 | 50 |
| **Expected contributions to plans in the following year** | **182** | 181 | 129 | **118** | 183 | 224 | **109** | 196 | 248 |

1. See note 1 on page 92.

# Notes to the consolidated financial statements continued

## 23. 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 environmental remediation and decommissioning costs for various sites we own or have owned and other provisions, including restructuring plans and lease contracts we have entered into that are now loss making.

### Our strategy in action

We are committed to the protection and enhancement of the environment. However, we have acquired, owned and operated a number of businesses which have, during the course of their operations, created an environmental impact. Therefore we have a provision that reflects the expected cost to remediate these sites. Current operations will seldom result in new sites with significant expected costs being added to the provision.

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.

Provision is made for decommissioning and environmental costs, based on future estimated expenditures, discounted to present values. An initial estimate of decommissioning and environmental costs attributable to property, plant and equipment is recorded as part of the original cost of the related property, plant and equipment.

Changes in the provision arising from revised estimates or discount rates or changes in the expected timing of expenditures that relate to property, plant and equipment are recorded as adjustments to their carrying value and depreciated prospectively over their remaining estimated useful economic lives; otherwise such changes are recognised in the income statement.

The unwinding of the discount is included within the income statement as a financing charge.

| | Environmental £m | Decommissioning £m | Restructuring £m | Emissions £m | Other £m | Total provisions £m |
|---|---|---|---|---|---|---|
| At 1 April 2012 | 1,158 | 112 | 70 | 23 | 368 | 1,731 |
| Exchange adjustments | 45 | 5 | – | 1 | 14 | 65 |
| Additions | 92 | – | 31 | 1 | 83 | 207 |
| Unused amounts reversed | (55) | (20) | (5) | (3) | (4) | (87) |
| Unwinding of discount | 59 | – | – | – | 16 | 75 |
| Utilised | (101) | (16) | (43) | (14) | (57) | (231) |
| At 31 March 2013 | 1,198 | 81 | 53 | 8 | 420 | 1,760 |
| Exchange adjustments | (79) | (7) | – | (1) | (25) | (112) |
| Additions | 11 | 84 | 86 | 7 | 42 | 230 |
| Unused amounts reversed | (14) | – | (1) | – | (3) | (18) |
| Unwinding of discount | 57 | – | – | – | 16 | 73 |
| Utilised | (101) | (14) | (59) | – | (114) | (288) |
| **At 31 March 2014** | **1,072** | **144** | **79** | **14** | **336** | **1,645** |

| | 2014 £m | 2013 £m |
|---|---|---|
| Current | **282** | 308 |
| Non-current | **1,363** | 1,452 |
| | **1,645** | 1,760 |

## 23. Provisions continued

### Environmental provision

The environmental provision represents the estimated restoration and remediation costs relating to a number of sites owned and managed by subsidiary undertakings, together with certain US sites that National Grid no longer owns. The environmental provision is as follows:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Discounted £m | Undiscounted £m | Real discount rate | Discounted £m | Undiscounted £m | Real discount rate |
| UK sites[1] | **286** | **367** | **2%** | 302 | 397 | 2% |
| US sites[2] | **786** | **891** | **2%** | 896 | 1,014 | 2% |
| | **1,072** | **1,258** | | 1,198 | 1,411 | |

1. The remediation expenditure in the UK relates to old gas manufacturing sites and also to electricity transmission sites. Cash flows are expected to be incurred between 2014 and 2067. A number of uncertainties affect the calculation of the provision, including the impact of regulation, accuracy of the site surveys, unexpected contaminants, transportation costs, the impact of alternative technologies and changes in the discount rate. This provision incorporates our best estimate of the financial effect of these uncertainties, but future material changes in any of the assumptions could have a material impact on the calculation of the provision. The undiscounted amount is the undiscounted best estimate of the liability having regard to these uncertainties.
2. The remediation expenditure in the US is expected to be incurred between 2014 and 2059. The uncertainties regarding the calculation of this provision are similar to those considered in respect of UK sites. However, unlike the UK, with the exception of immaterial amounts of such costs, this expenditure is expected to be largely recoverable from ratepayers under the terms of various rate agreements in the US.

### Decommissioning provision

The decommissioning provision primarily represents both £55m (2013: £69m) of expenditure relating to asset retirement obligations expected to be incurred until 2058, and £72m (2013: £nil) of expenditure relating to the demolition of gas holders expected to be incurred until 2022. It also includes the net present value of the estimated expenditure (discounted at a real rate of 2%) expected to be incurred until 2038 in respect of the decommissioning of certain US nuclear generating units that National Grid no longer owns.

### Restructuring provision

The restructuring provision principally relates to business reorganisation costs in the UK and the US and is expected to be incurred until 2021.

### Emissions provision

The provision for emission costs is expected to be settled using emission allowances granted.

### Other provisions

Included within other provisions at 31 March 2014 are amounts provided in respect of onerous lease commitments and rates payable on surplus properties of £117m (2013: £165m) with expenditure expected to be incurred until 2018.

Other provisions also include £160m (2013: £174m) of estimated liabilities in respect of past events insured by insurance subsidiary undertakings, including employer liability claims. In accordance with insurance industry practice, these estimates are based on experience from previous years and there is, therefore, no identifiable payment date. It also includes £13m (2013: £13m) in respect of obligations associated with investments in joint ventures.

# Notes to the consolidated financial statements continued

## 24. Share capital

Ordinary share capital represents the total number of shares issued which are publicly traded. We also disclose the number of treasury shares the Company holds, which are shares that the Company has bought itself, predominantly to satisfy employee share option plan liabilities.

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 at 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.

| | Allotted, called up and fully paid | |
|---|---|---|
| | millions | £m |
| At 1 April 2012 | 3,701 | 422 |
| Issued during the year in lieu of dividends[1] | 94 | 11 |
| At 31 March 2013 | 3,795 | 433 |
| Issued during the year in lieu of dividends[1] | 59 | 6 |
| **At 31 March 2014** | **3,854** | **439** |

1. The issue of shares in lieu of dividends is considered to be a bonus issue under the terms of the Companies Act 2006 and the nominal value of the shares is charged to the share premium account.

The share capital of the Company consists of ordinary shares of $11\frac{17}{43}$ pence nominal value each including ADSs. The ordinary and ADSs allow holders to receive dividends and vote at general meetings of the Company. The Company holds treasury shares but may not exercise any rights over these shares including the entitlement to vote or receive dividends. There are no restrictions on the transfer or sale of ordinary shares.

In line with the provisions of the Companies Act 2006, the Company has amended its Articles of Association and ceased to have authorised share capital.

### Treasury shares

At 31 March 2014, the Company held 124m (2013: 129m) of its own shares. The market value of these shares as at 31 March 2014 was £1,019m (2013: £989m).

The maximum number of shares held during the year was 129m ordinary shares (2013: 135m) representing approximately 3.4% (2013: 3.6%) of the ordinary shares in issue as at 31 March 2014 and having a nominal value of £15m (2013: £15m).

## 25. Other equity reserves

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

Other equity reserves comprise the translation reserve (see accounting policy B), cash flow hedge reserve (see note 15), available-for-sale reserve (see note 13), the capital redemption reserve and the merger reserve. The merger reserve arose as a result of the application of merger accounting principles under the then prevailing UK GAAP, which under IFRS 1 was retained for mergers that occurred prior to the IFRS transition date. Under merger accounting principles, the difference between the carrying amount of the capital structure of the acquiring vehicle and that of the acquired business was treated as a merger difference and included within reserves.

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.

| | Translation £m | Cash flow hedge £m | Available-for-sale £m | Capital redemption £m | Merger £m | Total £m |
|---|---|---|---|---|---|---|
| At 1 April 2011 | 319 | (103) | 60 | 19 | (5,165) | (4,870) |
| Exchange adjustments | 27 | – | – | – | – | 27 |
| Net (losses)/gains taken to equity | – | (18) | 16 | – | – | (2) |
| Transferred to profit or loss | – | 19 | (9) | – | – | 10 |
| Tax | – | 2 | (2) | – | – | – |
| At 31 March 2012 | 346 | (100) | 65 | 19 | (5,165) | (4,835) |
| Exchange adjustments | 117 | – | – | – | – | 117 |
| Net (losses)/gains taken to equity | – | (31) | 20 | – | – | (11) |
| Transferred to profit or loss | – | 73 | (10) | – | – | 63 |
| Tax | – | (13) | (2) | – | – | (15) |
| At 31 March 2013 | 463 | (71) | 73 | 19 | (5,165) | (4,681) |
| Exchange adjustments | (158) | – | – | – | – | (158) |
| Net gains taken to equity | – | 63 | 6 | – | – | 69 |
| Transferred to profit or loss | – | 27 | (14) | – | – | 13 |
| Tax | – | (5) | 3 | – | – | (2) |
| **At 31 March 2014** | **305** | **14** | **68** | **19** | **(5,165)** | **(4,759)** |

The merger reserve represents the difference between the carrying value of subsidiary undertaking investments and their respective capital structures following the Lattice demerger from BG Group plc and the 1999 Lattice refinancing of £5,745m and merger differences of £221m and £359m.

The cash flow hedge reserve on interest rate swap contracts will be continuously transferred to the income statement until the borrowings are repaid. The amount due to be released from reserves to the income statement next year is £17m (pre-tax) and the remainder released with the same maturity profile as borrowings due after more than one year.

# Notes to the consolidated financial statements continued

## 26. Net debt

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

Funding and liquidity risk management is carried out by the treasury function under policies and guidelines approved by the Finance Committee of the Board. 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 falls outside the delegation of authority to management.

The primary objective of the treasury function is to manage our funding and liquidity requirements. A secondary objective is to manage the associated financial risks, in the form of interest rate risk and foreign exchange risk, to within pre-authorised parameters. Details of the main risks arising from our financing and commodity hedging activities can be found in the risk factors discussion starting on page 167 and in note 30 to the consolidated financial statements on pages 137 to 144.

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.

The movement in cash and cash equivalents is reconciled to movements in net debt.

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

| | 2014 £m | 2013 £m | 2012 £m |
|---|---|---|---|
| (Decrease)/increase in cash and cash equivalents | (283) | 335 | (43) |
| (Decrease)/increase in financial investments | (1,720) | 2,992 | (553) |
| Decrease/(increase) in borrowings and related derivatives | 1,021 | (4,304) | 154 |
| Net interest paid on the components of net debt | 841 | 756 | 721 |
| Change in debt resulting from cash flows | (141) | (221) | 279 |
| Changes in fair value of financial assets and liabilities and exchange movements | 1,360 | (536) | (87) |
| Net interest charge on the components of net debt | (1,053) | (1,017) | (1,042) |
| Reclassified as held for sale | – | – | (2) |
| Extinguishment of debt resulting from LIPA MSA transition (note 4) | 98 | – | – |
| Other non-cash movements | (25) | (58) | (14) |
| Movement in net debt (net of related derivative financial instruments) in the year | 239 | (1,832) | (866) |
| Net debt (net of related derivative financial instruments) at start of year | (21,429) | (19,597) | (18,731) |
| **Net debt (net of related derivative financial instruments) at end of year** | **(21,190)** | (21,429) | (19,597) |

**Composition of net debt**
Net debt is made up as follows:

| | 2014 £m | 2013 £m | 2012 £m |
|---|---|---|---|
| Cash, cash equivalents and financial investments | 3,953 | 6,102 | 2,723 |
| Borrowings and bank overdrafts | (25,950) | (28,095) | (23,025) |
| Derivatives | 807 | 564 | 705 |
| **Total net debt** | **(21,190)** | (21,429) | (19,597) |

# 26. Net debt continued

## (b) Analysis of changes in net debt

| | Cash and cash equivalents £m | Bank overdrafts £m | Net cash and cash equivalents £m | Financial investments £m | Borrowings £m | Derivatives £m | Total[1] £m |
|---|---|---|---|---|---|---|---|
| At 1 April 2011 | 384 | (42) | 342 | 2,939 | (23,156) | 1,144 | (18,731) |
| Cash flow | (52) | 9 | (43) | (577) | 1,343 | (444) | 279 |
| Fair value gains and losses and exchange movements | – | – | – | 8 | 22 | (117) | (87) |
| Interest income/(charges) | – | – | – | 23 | (1,187) | 122 | (1,042) |
| Reclassified as held for sale | – | – | – | (2) | – | – | (2) |
| Other non-cash movements | – | – | – | – | (14) | – | (14) |
| At 31 March 2012 | 332 | (33) | 299 | 2,391 | (22,992) | 705 | (19,597) |
| Cash flow | 325 | 10 | 335 | 2,963 | (3,433) | (86) | (221) |
| Fair value gains and losses and exchange movements | 14 | – | 14 | 47 | (452) | (145) | (536) |
| Interest income/(charges) | – | – | – | 30 | (1,137) | 90 | (1,017) |
| Other non-cash movements | – | – | – | – | (58) | – | (58) |
| At 31 March 2013 | 671 | (23) | 648 | 5,431 | (28,072) | 564 | (21,429) |
| Cash flow | (291) | 8 | (283) | (1,755) | 2,009 | (112) | (141) |
| Fair value gains and losses and exchange movements | (26) | – | (26) | (113) | 1,223 | 276 | 1,360 |
| Interest income/(charges) | – | – | – | 36 | (1,168) | 79 | (1,053) |
| Extinguishment of debt resulting from LIPA MSA transition (note 4) | – | – | – | – | 98 | – | 98 |
| Other non-cash movements | – | – | – | – | (25) | – | (25) |
| **At 31 March 2014** | **354** | **(15)** | **339** | **3,599** | **(25,935)** | **807** | **(21,190)** |
| Balances at 31 March 2014 comprise: | | | | | | | |
| Non-current assets | – | – | – | – | – | 1,557 | 1,557 |
| Current assets | 354 | – | 354 | 3,599 | – | 413 | 4,366 |
| Current liabilities | – | (15) | (15) | – | (3,496) | (339) | (3,850) |
| Non-current liabilities | – | – | – | – | (22,439) | (824) | (23,263) |
| | **354** | **(15)** | **339** | **3,599** | **(25,935)** | **807** | **(21,190)** |

1. Includes accrued interest at 31 March 2014 of £239m (2013: £250m).

# Notes to the consolidated financial statements

## – supplementary information

**This section includes information that is important to enable a full understanding of our financial position, particularly areas of potential risk that could affect us in the future.**

**We also include specific disclosures for British Transco Finance Inc., Niagara Mohawk Power Corporation and National Grid Gas plc in accordance with various rules including Rule 3-10 of Regulation S-X (a US SEC requirement), as they have issued public debt securities which have been guaranteed by National Grid plc and one of its subsidiary companies, National Grid Gas plc. Additional disclosures have also been included in respect of the two guarantor companies. These disclosures are in lieu of publishing separate financial statements for these companies. See note 34 for further information.**

## 27. 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 operating lease rentals, energy purchase agreements and contracts for the repurchase of network 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 obligations that will remain for a specific period.

| | 2014 £m | 2013 £m |
|---|---|---|
| **Future capital expenditure** | | |
| Contracted for but not provided | **2,624** | 3,011 |
| **Operating lease commitments** | | |
| Less than 1 year | **84** | 109 |
| In 1-2 years | **76** | 84 |
| In 2-3 years | **70** | 74 |
| In 3-4 years | **66** | 72 |
| In 4-5 years | **56** | 70 |
| More than 5 years | **278** | 333 |
| | **630** | 742 |
| **Energy purchase commitments**[1] | | |
| Less than 1 year | **1,103** | 1,094 |
| In 1-2 years | **481** | 535 |
| In 2-3 years | **356** | 394 |
| In 3-4 years | **279** | 306 |
| In 4-5 years | **235** | 263 |
| More than 5 years | **1,083** | 1,403 |
| | **3,537** | 3,995 |
| **Guarantees and letters of credit** | | |
| Guarantee of sublease for US property (expires 2040) | **232** | 293 |
| Guarantees of certain obligations of Grain LNG Import Terminal (expire up to 2028) | **155** | 159 |
| Guarantee of certain obligations for construction of HVDC West Coast Link (expected expiry 2016) | **594** | 618 |
| Other guarantees and letters of credit (various expiry dates) | **271** | 262 |
| | **1,252** | 1,332 |

1. Energy purchase commitments relate to contractual commitments to purchase electricity or gas that are used to satisfy physical delivery requirements to our customers or for energy that we use ourselves (ie normal purchase, sale or usage) and hence are accounted for as ordinary purchase contracts. Details of commodity contracts that do not meet the normal purchase, sale or usage criteria, and hence are accounted for as derivative contracts, are shown in note 30 (e) on page 142.

The total of future minimum sublease payments expected to be received under non-cancellable subleases is £21m (2013: £23m).

Through the ordinary course of our operations, we are party to various litigation, claims and investigations. We do not expect the ultimate resolution of any of these proceedings to have a material adverse effect on our results of operations, cash flows or financial position.

## 28. Related party transactions

A related party is a company or individual who 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 plc. The related parties identified include joint ventures, associates, 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:

| | 2014 £m | 2013 £m | 2012 £m |
|---|---|---|---|
| Sales: Goods and services supplied to a pension plan and joint ventures | **15** | 10 | 10 |
| Purchases: Goods and services received from joint ventures and associates[1] | **128** | 133 | 95 |
| Receivable from a pension plan and joint ventures | **3** | 3 | 2 |
| Payable to joint ventures and associates | **5** | 6 | 6 |
| Dividends received from joint ventures and associates[2] | **38** | 21 | 26 |

1. During the year the Company received goods and services from a number of joint ventures and associates including Iroquois Gas Transmission System, L.P. of £30m (2013: £37m; 2012: £39m), Millennium Pipeline Company, LLC of £31m (2013: £35m; 2012: £32m) for the transportation of gas in the US and NGET/SPT Upgrades Limited of £67m (2013: £52m; 2012: £14m) for the construction of a transmission link in the UK.
2. Dividends were received from BritNed Development Limited of £17m (2013: £nil; 2012: £nil), Iroquois Gas Transmission System, L.P. of £11m (2013: £12m; 2012: £17m) and Millennium Pipeline Company, LLC of £10m (2013: £9m; 2012: £9m).

Details of investments in principal subsidiary undertakings, joint ventures and associates are disclosed in note 32 and information relating to pension fund arrangements is disclosed in notes 22 and 29. For details of Directors' and key management remuneration, refer to the audited section of the Remuneration Report and note 3 (c).

## 29. Actuarial information on pensions and other post-retirement benefits

Further details of the DB plans terms and the actuarial assumptions used to value the obligations are set out in this note.

When deciding on these assumptions we take independent actuarial advice. Comparatively small changes in the assumptions applied may have a significant effect on the overall deficit or surplus of a DB plan.

### UK pension plans

National Grid's DB pension arrangements are funded with assets held in separate trustee administered funds. The arrangements are managed by trustee companies with boards consisting of company and member appointed directors. The directors are required to manage the arrangements in accordance with local regulations and the arrangements' governing documents, acting on behalf of its beneficiaries.

The arrangements are subject to independent actuarial funding valuations at least every three years and following consultation and agreement with us, the qualified actuary certifies the employers' contribution, which, together with the specified contributions payable by the employees and proceeds from the plans' assets, are expected to be sufficient to fund the benefits payable. The last full actuarial valuations were carried out as at 31 March 2010. The 2013 valuations are ongoing and are expected to be agreed by the end of June.

The results of the 2010 valuations are shown below:

| | NGUKPS[1] | NGEG of ESPS[2] |
|---|---|---|
| Latest full actuarial valuation | 31 March 2010 | 31 March 2010 |
| Actuary | Towers Watson | Aon Hewitt |
| Market value of scheme assets at latest valuation | £13,399m | £1,531m |
| Actuarial value of benefits due to members | £(13,998)m | £(2,038)m |
| Market value as percentage of benefits | 96% | 75% |
| Funding deficit | £599m | £507m |
| Funding deficit (net of tax) | £479m | £406m |

1. National Grid UK Pension Scheme.
2. National Grid Electricity Group of the Electricity Supply Pension Scheme.

Following consultations during the past year with affected employees and our trade union partners, and the positive outcome of trade union ballots, National Grid, working with the Trustees, will implement changes to the benefits provided by its two UK DB pension schemes from 1 April 2014. From April 2014 an annual cap will be placed on future increases to the salary used to calculate pensions at the lower of 3% or the annual increase in RPI. This capped salary will apply to all pensionable service from 1 April 2013 onwards. These changes have resulted in a past service credit of £11m to the income statement (see note 22) and a change to the salary increase assumption which affects how our DB liabilities as at 31 March 2014 have been calculated.

The aim of these changes is to ensure our Schemes remain affordable and sustainable over the coming years.

# Notes to the consolidated financial statements continued

## 29. Actuarial information on pensions and other post-retirement benefits continued

### National Grid UK Pension Scheme

The 2010 actuarial funding valuation showed that, based on long-term financial assumptions, the contribution rate required to meet future benefit accrual was 35% of pensionable earnings (32% by employers and 3% by employees). In addition, National Grid makes payments to the scheme to cover administration costs and the Pension Protection Fund levy. The employer contribution rate and administration costs are being reviewed as part of the 2013 valuation.

Following the 2010 valuation, National Grid and the Trustees agreed a recovery plan which would see the funding deficit repaid by 31 March 2027. Under the schedule of contributions, no deficit contributions were made in 2010/11 or 2011/12. Annual payments of £47m, rising in line with the RPI from March 2010, commenced in 2012/13 and (subject to the current valuation discussions) are due to continue until 2027. As part of the initial 2013 valuation discussions with the Trustees an additional payment of £6m was paid in March 2014.

As part of the 2010 agreement, National Grid has established security account arrangements with a charge in favour of the Trustees. The value of the assets in the security account at 31 March 2014 was approximately £199m. The assets in the security account will be paid to the scheme in the event that National Grid Gas plc (NGG) is subject to an insolvency event, or is given notice of less than 12 months that Ofgem intends to revoke its licence under the Gas Act 1986. The assets in the security account will be released back to National Grid if the scheme moves into surplus.

This scheme ceased to allow new hires to join from 1 April 2002. A DC section of the scheme was offered for employees joining after this date, which closed to future contributions on 31 October 2013 and was replaced by The National Grid YouPlan (see below).

### National Grid Electricity Group of the Electricity Supply Pension Scheme

The 2010 actuarial funding valuation showed that, based on long-term financial assumptions, the contribution rate required to meet future benefit accrual was 29.6% of pensionable earnings (23.7% by employers and an average of 5.9% by employees). The employer contribution rate is being reviewed as part of the 2013 valuation.

Following the 2010 valuation, National Grid and the Trustees agreed a recovery plan that would see the funding deficit repaid by 31 March 2027. Under the schedule of contributions, payments of £45m were made in 2010/11 and 2011/12 and a further payment of £38m was made in 2012/13. Thereafter annual payments of £38m rising in line with RPI are due to continue until 2027. The actual payment made in 2013/14 was £45m which included an additional payment of £7m following initial 2013 valuation discussions with the Trustees. A further £35m paid in 2011/12 to support a de-risking initiative has been recognised from a funding perspective during 2013/14.

As part of this agreement, National Grid has established security account arrangements with a charge in favour of the Trustees. The value of the assets in the security account at 31 March 2014 was approximately £35m. The assets in the security account will be paid to the scheme in the event that National Grid Electricity Transmission plc (NGET) is subject to an insolvency event, or ceases to hold a licence granted under the Electricity Act 1989. The assets in the security account will be released back to National Grid if the scheme moves into surplus.

National Grid has also agreed to make a payment in respect of the deficit up to a maximum of £220m should certain triggers be breached; namely if NGET ceases to hold the licence granted under the Electricity Act 1989 or NGET's credit rating by two out of three specified agencies falls below certain agreed levels for a period of 40 days.

The scheme closed to new members from 1 April 2006.

### The National Grid YouPlan

Following a review of the DC section of the National Grid UK Pension Scheme, National Grid established a new DC trust, The National Grid YouPlan (YouPlan). This was launched on 1 November 2013 and future contributions for active members of the DC section were paid to YouPlan from this date.

Under the rules of the plan, National Grid double matches contributions to YouPlan currently up to a maximum of 5% of employee salary. Member accounts built up in the DC section prior to 1 November 2013 will be transferred to YouPlan in 2014.

YouPlan is the qualifying scheme used for automatic enrolment and National Grid's staging date was 1 April 2013. All new hires are enrolled into YouPlan.

### US pension plans

National Grid's DB pension plans in the US provide annuity or lump sum payments for vested employees. Non-union employees hired on or after 1 January 2011 are provided with a core contribution into the DC plan, irrespective of the employee's contribution to the plan. A core contribution in the DC plan is also provided to new hires in ten groups of represented US employees. In addition, an employer match is offered to eligible employees in the DC plan on their elective deferrals into the plan. The assets of the plans are held in separate trusts and administered by the fiduciary committees.

Employees do not contribute to the DB pension plans. Employer contributions are made in accordance with the rules set forth by the US Internal Revenue Code and can vary according to the funded status of the plans and the amounts that are tax deductible. At present, there is some flexibility in the amount that is contributed on an annual basis. In general, the Company's policy for funding the US pension plans is to contribute amounts collected in rates and capitalised in the rate bases during the year. These contributions will be no less than the amounts needed to meet the requirements of the Pension Protection Act of 2006.

# 29. Actuarial information on pensions and other post-retirement benefits continued

## US retiree healthcare and life insurance plans

National Grid provides healthcare and life insurance benefits to eligible retired US employees. Eligibility is based on certain age and length of service requirements and in most cases retirees contribute to the cost of their healthcare coverage. In the US, there is no governmental requirement to pre-fund post-retirement health and welfare plans. However, in general, the Company's policy for funding the US retiree healthcare and life insurance plans is to contribute amounts collected in rates and capitalised in the rate bases during the year.

## Asset allocations

Within the asset allocations below there is significant diversification across regions, asset managers, currencies and bond categories.

### UK pensions

| | 2014 | | | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Quoted £m | Unquoted £m | Total £m | Quoted £m | Unquoted £m | Total £m | Quoted £m | Unquoted £m | Total £m |
| Equities[1] | **4,045** | **620** | **4,665** | 4,825 | 546 | 5,371 | 4,796 | 570 | 5,366 |
| Corporate bonds[2] | **5,706** | **–** | **5,706** | 5,804 | – | 5,804 | 5,330 | – | 5,330 |
| Government securities | **4,161** | **–** | **4,161** | 4,743 | – | 4,743 | 3,906 | – | 3,906 |
| Property | **33** | **1,057** | **1,090** | – | 1,072 | 1,072 | – | 1,160 | 1,160 |
| Diversified alternatives[3] | **–** | **793** | **793** | – | – | – | – | – | – |
| Other[4] | **1,031** | **(37)** | **994** | 426 | (24) | 402 | 407 | (62) | 345 |
| **Total** | **14,976** | **2,433** | **17,409** | 15,798 | 1,594 | 17,392 | 14,439 | 1,668 | 16,107 |

1. Included within equities at 31 March 2014 were ordinary shares of National Grid plc with a value of £15m (2013: £16m; 2012: £13m).
2. Included within corporate bonds at 31 March 2014 was an investment in a number of bonds issued by subsidiary undertakings with a value of £72m (2013: £69m; 2012: £50m).
3. Includes return seeking non-conventional asset classes.
4. Includes liability-driven investment vehicles, cash and cash type instruments.

### US pensions

| | 2014 | | | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Quoted £m | Unquoted £m | Total £m | Quoted £m | Unquoted £m | Total £m | Quoted £m | Unquoted £m | Total £m |
| Equities | **508** | **1,225** | **1,733** | 507 | 1,289 | 1,796 | 619 | 1,025 | 1,644 |
| Corporate bonds | **823** | **336** | **1,159** | 863 | 295 | 1,158 | 733 | 229 | 962 |
| Government securities | **632** | **28** | **660** | 707 | 19 | 726 | 649 | 20 | 669 |
| Property | **–** | **189** | **189** | – | 175 | 175 | – | 148 | 148 |
| Diversified alternatives[1] | **–** | **434** | **434** | – | 465 | 465 | – | 411 | 411 |
| Other | **–** | **54** | **54** | – | 58 | 58 | – | 16 | 16 |
| **Total** | **1,963** | **2,266** | **4,229** | 2,077 | 2,301 | 4,378 | 2,001 | 1,849 | 3,850 |

1. Includes return seeking non-conventional asset classes.

### US other post-retirement benefits

| | 2014 | | | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Quoted £m | Unquoted £m | Total £m | Quoted £m | Unquoted £m | Total £m | Quoted £m | Unquoted £m | Total £m |
| Equities | **245** | **852** | **1,097** | 195 | 774 | 969 | 252 | 523 | 775 |
| Corporate bonds | **2** | **10** | **12** | 2 | 11 | 13 | 1 | 10 | 11 |
| Government securities | **357** | **1** | **358** | 361 | 2 | 363 | 262 | 4 | 266 |
| Diversified alternatives[1] | **43** | **110** | **153** | 43 | 127 | 170 | 87 | 53 | 140 |
| **Total** | **647** | **973** | **1,620** | 601 | 914 | 1,515 | 602 | 590 | 1,192 |

1. Includes return seeking non-conventional asset classes.

## Target asset allocations

Each plan's investment strategy is formulated specifically in order to manage risk, through investment in diversified asset classes, including the use of liability matching assets and where appropriate through the employment of interest rate and inflation hedging instruments. The target asset allocation of the plans as at 31 March 2014 is as follows:

| | UK pensions % | US pensions % | US other post-retirement benefits % |
|---|---|---|---|
| Equities | 31 | 47 | 70 |
| Other | 69 | 53 | 30 |
| **Total** | 100 | 100 | 100 |

# Notes to the consolidated financial statements continued

## 29. Actuarial information on pensions and other post-retirement benefits continued

### Actuarial assumptions

The Company has applied the following financial assumptions in assessing DB liabilities:

| | UK pensions | | | US pensions | | | US other post-retirement benefits | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2014 %** | 2013 % | 2012 % | **2014 %** | 2013 % | 2012 % | **2014 %** | 2013 % | 2012 % |
| Discount rate[1] | **4.3** | 4.3 | 4.8 | **4.8** | 4.7 | 5.1 | **4.8** | 4.7 | 5.1 |
| Rate of increase in salaries[2] | **3.6** | 4.1 | 4.0 | **3.5** | 3.5 | 3.5 | **3.5** | 3.5 | 3.5 |
| Rate of increase in RPI[3] | **3.3** | 3.4 | 3.2 | **n/a** | n/a | n/a | **n/a** | n/a | n/a |
| Initial healthcare cost trend rate | **n/a** | n/a | n/a | **n/a** | n/a | n/a | **8.0** | 8.0 | 8.0 |
| Ultimate healthcare cost trend rate | **n/a** | n/a | n/a | **n/a** | n/a | n/a | **5.0** | 5.0 | 5.0 |

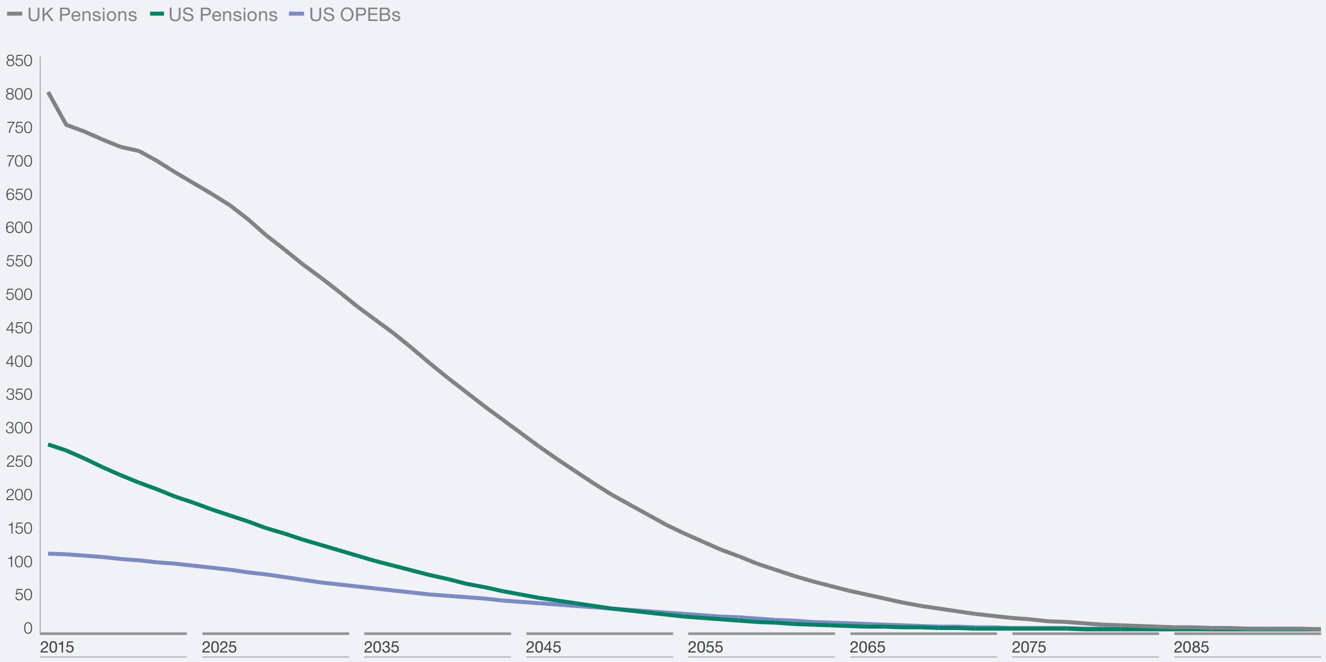
1. The discount rates for pension liabilities have been determined by reference to appropriate yields on high-quality corporate bonds prevailing in the UK and US debt markets at the reporting date.
2. A promotional scale has also been used where appropriate. The UK assumption stated is that relating to service prior to 1 April 2013. The UK assumption for the rate of increase in salaries for service after this date is 2.5%.
3. This is the key assumption that determines assumed increases in pensions in payment and deferment in the UK only. The assumptions for the UK were 3.3% (2013: 3.4%; 2012: 3.2%) for increases in pensions in payment and 3.3% (2013: 3.4%; 2012: 3.2%) for increases in pensions in deferment.

| | 2014 | | 2013 | | 2012 | |
|---|---|---|---|---|---|---|
| | **UK years** | **US years** | UK years | US years | UK years | US years |
| Assumed life expectations for a retiree age 65 | | | | | | |
| Today | | | | | | |
| Males | **22.9** | **20.6** | 22.7 | 19.5 | 22.5 | 19.4 |
| Females | **25.4** | **22.9** | 25.2 | 21.4 | 25.0 | 21.3 |
| In 20 years | | | | | | |
| Males | **25.2** | **22.8** | 25.0 | 21.0 | 24.9 | 20.9 |
| Females | **27.8** | **24.7** | 27.6 | 22.2 | 27.5 | 22.2 |

### Maturity profile of defined benefit obligations

The weighted average duration of the DB obligation for each category of scheme is 16 years for UK pension schemes; 13 years for US pension schemes and 15 years for US other post-retirement benefits. The forecast timing of benefits payable to scheme members for each of these categories is shown on a net present value basis in the chart below.

**Maturity profile**
£m



## 30. Financial risk management

Our activities expose us to a variety of financial risk including currency risk, interest rate risk, commodity price risk, credit risk, capital risk and liquidity risk. Our risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential volatility of financial performance of these risks. We use financial instruments, including derivative financial instruments, to manage risks of this type.

This note describes our approach to managing risk, including an analysis of assets and liabilities by currency type and an analysis of interest rate category for our net debt. We are required by accounting standards to also include a number of specific disclosures (such as a maturity analysis of contractual undiscounted cash flows) and have included these requirements below.

Risk management related to financing activities is carried out by a central treasury department under policies approved by the Finance Committee of the Board. The objective of the treasury department is to manage funding and liquidity requirements, including managing associated financial risks, to within acceptable boundaries. The Finance Committee provides written principles for overall risk management, as well as written policies covering specific areas such as foreign exchange risk, interest rate risk, credit risk, liquidity risk, use of derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity.

We have exposure to the following risks, which are described in more detail below:

- credit risk;
- liquidity risk;
- interest rate risk;
- currency risk;
- commodity risk; and
- capital risk

### (a) Credit risk

We are exposed to the risk of loss resulting from counterparties' default on their commitments including failure to pay or make a delivery on a contract. This risk is inherent in our commercial business activities. We are exposed to credit risk on our cash and cash equivalents, derivative financial instruments, deposits with banks and financial institutions, as well as credit exposures to wholesale and retail customers, including outstanding receivables and committed transactions.

**Treasury credit risk**

Counterparty risk arises from the investment of surplus funds and from the use of derivative instruments. As at 31 March 2014, the following limits were in place for investments held with banks and financial institutions:

| | Maximum limit £m | Long-term limit £m |
|---|---|---|
| AAA rated G8 sovereign entities | Unlimited | Unlimited |
| Triple 'A' vehicles | 311 | 263 |
| Triple 'A' range institutions (AAA) | 1,060 to 1,599 | 534 to 837 |
| Double 'A' range institutions (AA) | 633 to 797 | 322 to 398 |
| Single 'A' range institutions (A) | 218 to 311 | 111 to 159 |

As at 31 March 2013 and 2014, we had a number of exposures to individual counterparties. In accordance with our treasury policies, counterparty credit exposure utilisations are monitored daily against the counterparty credit limits. Counterparty credit ratings and market conditions are reviewed continually with limits being revised and utilisation adjusted, if appropriate. Management does not expect any significant losses from non performance by these counterparties.

**Commodity credit risk**

The credit policy for commodity transactions is owned and monitored by the Executive Energy Risk Committee, under authority delegated by the Board and Executive Committee, and establishes controls and procedures to determine, monitor and minimise the credit risk of counterparties.

**Wholesale and retail credit risk**

Our principal commercial exposure in the UK is governed by the credit rules within the regulated codes Uniform Network Code and Connection and Use of System Code. These set out the level of credit relative to the RAV for each credit rating. In the US, we are required to supply electricity and gas under state regulations. Our credit policies and practices are designed to limit credit exposure by collecting security deposits prior to providing utility services, or after utility service has commenced if certain applicable regulatory requirements are met. Collection activities are managed on a daily basis. Sales to retail customers are usually settled in cash, cheques, electronic bank payments or by using major credit cards. We are committed to measuring, monitoring, minimising and recording counterparty credit risk in our wholesale business. The utilisation of credit limits is regularly monitored and collateral is collected against these accounts when necessary. Management does not expect any significant losses of receivables that have not been provided for as shown in note 17.

# Notes to the consolidated financial statements continued

## 30. Financial risk management continued

### (a) Credit risk continued

**Offsetting financial assets and liabilities**

The following tables set out our financial assets and liabilities which are subject to offset and to enforceable master netting arrangements or similar agreements. The tables show the amounts which are offset and reported net in the statement of financial position. Amounts which cannot be offset under IFRS, but which could be settled net under terms of master netting agreements if certain conditions arise, and with collateral received or pledged, are shown to present National Grid's net exposure.

Financial assets and liabilities on different transactions are only reported net if the transactions are with the same counterparty, a legal right of offset exists and the cash flows are intended to be settled on a net basis.

Amounts which do not meet the criteria for offsetting on the statement of financial position but could be settled net in certain circumstances principally relate to derivative transactions under ISDA (International Swaps and Derivatives Association) agreements where each party has the option to settle amounts on a net basis in the event of default of the other party.

Commodity contracts that have not been offset on the balance sheet may be settled net in certain circumstances under ISDA or NAESB (North American Energy Standards Board) agreements.

National Grid has similar arrangements in relation to bank account balances and bank overdrafts; and trade payables and trade receivables which are subject to general terms and conditions. However, these balances are immaterial.

| | | | | Related amounts available to be offset but not offset in statement of financial position | | |
|---|---|---|---|---|---|---|
| **As at 31 March 2014** | **Gross carrying amounts £m** | **Gross amounts offset[1] £m** | **Net amount presented in statement of financial position £m** | **Financial instruments £m** | **Cash collateral received/ pledged £m** | **Net amount £m** |
| **Assets** | | | | | | |
| Derivative financial instruments | **1,970** | **–** | **1,970** | **(609)** | **(831)** | **530** |
| Commodity contracts | **89** | **(2)** | **87** | **(7)** | **(2)** | **78** |
| | **2,059** | **(2)** | **2,057** | **(616)** | **(833)** | **608** |
| **Liabilities** | | | | | | |
| Derivative financial instruments | **(1,163)** | **–** | **(1,163)** | **609** | **374** | **(180)** |
| Commodity contracts | **(123)** | **–** | **(123)** | **7** | **–** | **(116)** |
| | **(1,286)** | **–** | **(1,286)** | **616** | **374** | **(296)** |
| **Total** | **773** | **(2)** | **771** | **–** | **(459)** | **312** |

| | | | | Related amounts available to be offset but not offset in statement of financial position | | |
|---|---|---|---|---|---|---|
| As at 31 March 2013 | Gross carrying amounts £m | Gross amounts offset[1] £m | Net amount presented in statement of financial position £m | Financial instruments £m | Cash collateral received/ pledged £m | Net amount £m |
| **Assets** | | | | | | |
| Derivative financial instruments | 2,245 | – | 2,245 | (891)[2] | (709) | 645 |
| Commodity contracts | 91 | (2) | 89 | (1) | – | 88 |
| | 2,336 | (2) | 2,334 | (892) | (709) | 733 |
| **Liabilities** | | | | | | |
| Derivative financial instruments | (1,681) | – | (1,681) | 891[2] | 440 | (350) |
| Commodity contracts | (140) | 1 | (139) | 1 | – | (138) |
| | (1,821) | 1 | (1,820) | 892 | 440 | (488) |
| Total | 515 | (1) | 514 | – | (269) | 245 |

1. The gross financial assets and liabilities offset in the statement of financial position primarily relate to commodity contracts. Offsets relate to margin payments for NYMEX gas futures which are traded on a recognised exchange.
2. Comparatives have been restated to present items on a basis consistent with the current year.

## 30. Financial risk management continued

### (b) Liquidity risk

Our policy is to determine our liquidity requirements by the use of both short-term and long-term cash flow forecasts. These forecasts are supplemented by a financial headroom analysis which is used to assess funding requirements for at least a 24 month period and maintain adequate liquidity for a continuous 12 month period.

We believe our contractual obligations, including those shown in commitments and contingencies in note 27 can be met from existing cash and investments, operating cash flows and other financings that we reasonably expect to be able to secure in the future, together with the use of committed facilities if required.

Our debt agreements and banking facilities contain covenants, including those relating to the periodic and timely provision of financial information by the issuing entity and financial covenants such as restrictions on the level of subsidiary indebtedness. Failure to comply with these covenants, or to obtain waivers of those requirements, could in some cases trigger a right, at the lender's discretion, to require repayment of some of our debt and may restrict our ability to draw upon our facilities or access the capital markets.

The following is an analysis of the contractual undiscounted cash flows payable under financial liabilities and derivative assets and liabilities as at the reporting date:

| At 31 March 2014 | Less than 1 year £m | 1-2 years £m | 2-3 years £m | More than 3 years £m | Total £m |
|---|---|---|---|---|---|
| **Non-derivative financial liabilities** | | | | | |
| Borrowings, excluding finance lease liabilities | (3,091) | (864) | (1,140) | (20,275) | (25,370) |
| Interest payments on borrowings[1] | (826) | (812) | (796) | (14,571) | (17,005) |
| Finance lease liabilities | (18) | (19) | (20) | (112) | (169) |
| Other non-interest bearing liabilities | (2,584) | (190) | – | – | (2,774) |
| **Derivative financial liabilities** | | | | | |
| Derivative contracts – receipts | 1,068 | 950 | 153 | 1,155 | 3,326 |
| Derivative contracts – payments | (556) | (861) | (144) | (1,638) | (3,199) |
| Commodity contracts | (177) | (30) | (22) | 2 | (227) |
| Total | (6,184) | (1,826) | (1,969) | (35,439) | (45,418) |

| At 31 March 2013 | Less than 1 year £m | 1-2 years £m | 2-3 years £m | More than 3 years £m | Total £m |
|---|---|---|---|---|---|
| **Non-derivative financial liabilities** | | | | | |
| Borrowings, excluding finance lease liabilities | (3,061) | (1,836) | (790) | (21,704) | (27,391) |
| Interest payments on borrowings[1] | (951) | (861) | (842) | (15,775) | (18,429) |
| Finance lease liabilities | (27) | (26) | (26) | (151) | (230) |
| Other non-interest bearing liabilities | (2,696) | (235) | – | – | (2,931) |
| **Derivative financial liabilities** | | | | | |
| Derivative contracts – receipts | 1,388 | 816 | 1,053 | 441 | 3,698 |
| Derivative contracts – payments[2] | (1,309) | (469) | (969) | (1,039) | (3,786) |
| Commodity contracts | (150) | (41) | (35) | (25) | (251) |
| Total | (6,806) | (2,652) | (1,609) | (38,253) | (49,320) |

1. The interest on borrowings is calculated based on borrowings held at 31 March without taking account of future issues. Floating-rate interest is estimated using a forward interest rate curve as at 31 March. Payments are included on the basis of the earliest date on which the Company can be required to settle.
2. The comparatives have been restated on a basis consistent with the current year.

# Notes to the consolidated financial statements continued

## 30. Financial risk management continued

### (c) Interest rate risk

National Grid's interest rate risk arises from our long-term borrowings. Borrowings issued at variable rates expose National Grid to cash flow interest rate risk, partially offset by cash held at variable rates. Borrowings issued at fixed rates expose National Grid to fair value interest rate risk.

Our interest rate risk management policy is to seek to minimise total financing costs (being interest costs and changes in the market value of debt) subject to constraints. We do this by using fixed and floating rate debt and derivative financial instruments including interest rate swaps, swaptions and forward rate agreements.

We hold some borrowings on issue that are inflation linked. We believe that these provide a partial economic offset to the inflation risk associated with our UK inflation linked revenues.

The table in note 19 sets out the carrying amount, by contractual maturity, of borrowings that are exposed to interest rate risk before taking into account interest rate swaps.

During 2014 and 2013, net debt was managed using derivative instruments to hedge interest rate risk as follows:

| | 2014 | | | | | 2013 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Fixed rate £m | Floating rate £m | Inflation linked £m | Other[1] £m | Total £m | Fixed rate £m | Floating rate £m | Inflation linked £m | Other[1] £m | Total £m |
| Cash and cash equivalents | 175 | 179 | – | – | 354 | 577 | 94 | – | – | 671 |
| Financial investments | 615 | 2,979 | – | 5 | 3,599 | 540 | 4,843 | – | 48 | 5,431 |
| Borrowings[2] | (15,585) | (3,520) | (6,836) | (9) | (25,950) | (17,767) | (3,700) | (6,617) | (11) | (28,095) |
| **Pre-derivative position** | (14,795) | (362) | (6,836) | (4) | (21,997) | (16,650) | 1,237 | (6,617) | 37 | (21,993) |
| Derivative effect[3] | 3,359 | (2,743) | 191 | – | 807 | 1,555 | (1,132) | 141 | – | 564 |
| **Net debt position** | (11,436) | (3,105) | (6,645) | (4) | (21,190) | (15,095) | 105 | (6,476) | 37 | (21,429) |

1. Represents financial instruments which are not directly affected by interest rate risk, such as investments in equity or other similar financial instruments.
2. Includes bank overdrafts.
3. The impact of 2014/15 (2013: 2013/14) maturing short-dated interest rate derivatives is included.

### (d) Currency risk

National Grid operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the dollar. Foreign exchange risk arises from future commercial transactions, recognised assets and liabilities, and investments in foreign operations.

Our policy for managing foreign exchange transaction risk is to hedge contractually committed foreign currency cash flows over a prescribed minimum size. Where foreign currency cash flow forecasts are less certain, our policy is to hedge a proportion of such cash flows based on the probability of those cash flows occurring. Instruments used to manage foreign exchange transaction risk include foreign exchange forward contracts and foreign exchange swaps.

Our policy for managing foreign exchange translation risk relating to our net investment in foreign operations is to maintain a percentage of net debt and foreign exchange forwards so as to provide an economic offset of our cash flows arising in the foreign currency. The primary managed foreign exchange exposure arises from the dollar denominated assets and liabilities held by our US operations, with a further small euro exposure in respect of a joint venture investment.

During 2014 and 2013, derivative financial instruments were used to manage foreign currency risk as follows:

| | 2014 | | | | | 2013 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Sterling £m | Euro £m | Dollar £m | Other £m | Total £m | Sterling £m | Euro £m | Dollar £m | Other £m | Total £m |
| Cash and cash equivalents | 16 | – | 338 | – | 354 | 238 | 1 | 432 | – | 671 |
| Financial investments | 1,879 | 111 | 1,553 | 56 | 3,599 | 3,938 | 124 | 1,289 | 80 | 5,431 |
| Borrowings[1] | (12,780) | (4,479) | (7,330) | (1,361) | (25,950) | (12,573) | (5,220) | (8,678) | (1,624) | (28,095) |
| **Pre-derivative position** | (10,885) | (4,368) | (5,439) | (1,305) | (21,997) | (8,397) | (5,095) | (6,957) | (1,544) | (21,993) |
| Derivative effect | 3,137 | 4,670 | (8,326) | 1,326 | 807 | 320 | 5,368 | (6,684) | 1,560 | 564 |
| **Net debt position** | (7,748) | 302 | (13,765) | 21 | (21,190) | (8,077) | 273 | (13,641) | 16 | (21,429) |

1. Includes bank overdrafts.

The overall exposure to dollars largely relates to our net investment hedge activities as described in note 15.

# 30. Financial risk management continued

## (d) Currency risk continued

The currency exposure on other financial instruments is as follows:

| | 2014 | | | | | 2013 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Sterling £m | Euro £m | Dollar £m | Other £m | Total £m | Sterling £m | Euro £m | Dollar £m | Other £m | Total £m |
| Trade and other receivables | **142** | **–** | **1,623** | **–** | **1,765** | 151 | – | 1,338 | – | 1,489 |
| Trade and other payables | **(1,370)** | **–** | **(1,291)** | **–** | **(2,661)** | (1,328) | – | (1,437) | – | (2,765) |
| Other non-current liabilities | **(16)** | **–** | **(220)** | **–** | **(236)** | (22) | – | (283) | – | (305) |

The carrying amounts of other financial instruments are denominated in the above currencies, which in most instances are the functional currency of the respective subsidiaries. Our exposure to dollars is due to activities in our US subsidiaries. We do not have any other significant exposure to currency risk on these balances.

## (e) Commodity risk

We purchase electricity and gas to supply our customers in the US and to meet our own energy needs. Substantially all our costs of purchasing electricity and gas for supply to customers are recoverable at an amount equal to cost. The timing of recovery of these costs can vary between financial periods leading to an under- or over-recovery within any particular year, that can lead to large fluctuations in the income statement. We follow approved policies to manage price and supply risks for our commodity activities.

Our energy procurement risk management policy and delegations of authority govern our US commodity trading activities for energy transactions. The purpose of this policy is to ensure we transact within pre-defined risk parameters and only in the physical and financial markets where we or our customers have a physical market requirement. In addition, state regulators require National Grid to manage commodity risk and cost volatility prudently through diversified pricing strategies. In some jurisdictions we are required to file a plan outlining our strategy to be approved by regulators. In certain cases we might receive guidance with regard to specific hedging limits.

Energy purchase contracts for the forward purchase of electricity or gas that are used to satisfy physical delivery requirements to customers or for energy that the Company uses itself meet the normal purchase, sale or usage exemption of IAS 39. They are, therefore, not recognised in the financial statements. Disclosure of commitments under such contracts is made in note 27.

We enter into forward contracts for the purchase of commodities, some of which do not meet the own use exemption for accounting purposes and hence are accounted for as derivatives. We also enter into derivative financial instruments linked to commodity prices, including index-linked futures, swaps and options contracts. These derivative financial instruments are used to manage market price volatility and are carried at fair value on the statement of financial position, with the mark-to-market changes reflected through earnings.

# Notes to the consolidated financial statements continued

## 30. Financial risk management continued

### (e) Commodity risk continued

The fair value of our commodity contracts by type can be analysed as follows:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Assets £m | Liabilities £m | Total £m | Assets £m | Liabilities £m | Total £m |
| **Commodity purchase contracts accounted for as derivative contracts** | | | | | | |
| Forward purchases of electricity | 1 | (49) | (48) | – | (89) | (89) |
| Forward purchases of gas | 30 | (66) | (36) | 46 | (45) | 1 |
| **Derivative financial instruments linked to commodity prices** | | | | | | |
| Electricity swaps | 26 | (6) | 20 | 16 | (1) | 15 |
| Electricity options | 22 | – | 22 | 16 | – | 16 |
| Gas swaps | 7 | (2) | 5 | 10 | (4) | 6 |
| Gas options | 1 | – | 1 | 1 | – | 1 |
| | 87 | (123) | (36) | 89 | (139) | (50) |

The maturity profile of commodity contracts is as follows:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Assets £m | Liabilities £m | Total £m | Assets £m | Liabilities £m | Total £m |
| Less than one year | 42 | (77) | (35) | 42 | (69) | (27) |
| **Current** | 42 | (77) | (35) | 42 | (69) | (27) |
| In 1-2 years | 13 | (22) | (9) | 13 | (23) | (10) |
| In 2-3 years | 15 | (17) | (2) | 10 | (23) | (13) |
| In 3-4 years | 4 | (7) | (3) | 14 | (16) | (2) |
| In 4-5 years | 3 | – | 3 | 2 | (8) | (6) |
| More than 5 years | 10 | – | 10 | 8 | – | 8 |
| **Non-current** | 45 | (46) | (1) | 47 | (70) | (23) |
| **Total** | 87 | (123) | (36) | 89 | (139) | (50) |

For each class of commodity contract, our exposure based on the notional quantities is as follows:

| | 2014 | 2013 |
|---|---|---|
| Forward purchases of electricity[1] | 1,740 GWh | 2,595 GWh |
| Forward purchases/sales of gas[2] | 84m Dth | 59m Dth |
| Electricity swaps | 6,603 GWh | 6,309 GWh |
| Electricity options | 28,760 GWh | 32,999 GWh |
| Gas swaps | 50m Dth | 66m Dth |
| Gas options | 23m Dth | 4m Dth |
| NYMEX gas futures[3] | 20m Dth | 17m Dth |

1. Forward electricity purchases have terms up to four years. The contractual obligations under these contracts are £106m (2013: £174m).
2. Forward gas purchases have terms up to five years. The contractual obligations under these contracts are £171m (2013: £119m).
3. NYMEX gas futures have been offset with related margin accounts (see note 30 (a) on page 137).

### (f) Capital risk management

National Grid's objectives when managing capital are: to safeguard our ability to continue as a going concern; to remain within regulatory constraints of our regulated operating companies; and to maintain an efficient mix of debt and equity funding thus achieving an optimal capital structure and cost of capital. We regularly review and maintain or adjust the capital structure as appropriate in order to achieve these objectives.

Maintaining appropriate credit ratings for our regulated companies is an important aspect of our capital risk management strategy and balance sheet efficiency. We monitor our balance sheet efficiency using several metrics including our interest cover. Interest cover for the year ended 31 March 2014 was 4.1 (2013: 3.9). Our long-term target range for interest cover is greater than 3.0, which we believe is consistent with single A range long-term senior unsecured debt credit ratings within our main UK operating companies, NGET and NGG, based on guidance from the rating agencies.

In addition, we monitor the RAV gearing within each of NGET and the regulated transmission and distribution businesses within NGG. This is calculated as net debt expressed as a percentage of RAV, and indicates the level of debt employed to fund our UK regulated businesses. It is compared with the level of RAV gearing indicated by Ofgem as being appropriate for these businesses, at around 60-65%.

## 30. Financial risk management continued

### (f) Capital risk management continued

The majority of our regulated operating companies in the US and the UK (and one intermediate UK holding company), which are all consolidated subsidiaries of National Grid, are subject to certain restrictions on the payment of dividends by administrative order (by regulators relevant to the individual company), contract and/or licence. The types of restrictions that a company may have that would prevent a dividend being declared or paid unless they are met include:

- dividends must be approved in advance by the relevant US state regulatory commission;
- the subsidiary must have at least two recognised rating agency credit ratings of at least investment grade;
- dividends must be limited to cumulative retained earnings, including pre-acquisition retained earnings;
- National Grid plc must maintain an investment grade credit rating and if that rating is the lowest investment grade bond rating it cannot have a negative watch/review downgrade notice by a credit rating agency;
- the subsidiary must not carry on any activities other than those permitted by the licences;
- the subsidiary must not create any cross-default obligations or give or receive any intra-group cross-subsidies; and
- the percentage of equity compared with total capital of the subsidiary must remain above certain levels.

There is a further restriction relating only to the Narragansett Electric Company, which is required to maintain its consolidated net worth above certain levels.

These restrictions are subject to alteration in the US as and when a new rate case or rate plan is agreed with the relevant regulatory bodies for each operating company and in the UK through the normal licence review process.

As most of our business is regulated, at 31 March 2014 the majority of our net assets are subject to some of the restrictions noted above. These restrictions are not considered to be significantly onerous, nor do we currently expect they will prevent the planned payment of dividends in future in line with our dividend policy.

Some of our regulatory and bank loan agreements additionally impose lower limits for the long-term credit ratings that certain companies within the Group must hold. All the above requirements are monitored on a regular basis in order to ensure compliance. The Company has complied with all externally imposed capital requirements to which it is subject.

### (g) Fair value analysis

The financial instruments included on the statement of financial position are measured at fair value. These fair values can be categorised into hierarchy levels that are representative of the inputs used in measuring the fair value. The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used.

| | 2014 | | | | 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | Level 1 £m | Level 2 £m | Level 3 £m | Total £m | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
| **Assets** | | | | | | | | |
| Available-for-sale investments | 2,786 | 214 | – | 3,000 | 4,510 | 209 | – | 4,719 |
| Derivative financial instruments | – | 1,950 | 20 | 1,970 | – | 2,197 | 48 | 2,245 |
| Commodity contracts | – | 34 | 53 | 87 | – | 26 | 63 | 89 |
| | 2,786 | 2,198 | 73 | 5,057 | 4,510 | 2,432 | 111 | 7,053 |
| **Liabilities** | | | | | | | | |
| Derivative financial instruments | – | (1,043) | (120) | (1,163) | – | (1,529) | (152) | (1,681) |
| Commodity contracts | – | (12) | (111) | (123) | – | (5) | (134) | (139) |
| | – | (1,055) | (231) | (1,286) | – | (1,534) | (286) | (1,820) |
| **Total** | 2,786 | 1,143 | (158) | 3,771 | 4,510 | 898 | (175) | 5,233 |

Level 1: Financial instruments with quoted prices for identical instruments in active markets.

Level 2: Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are based directly or indirectly on observable market data.

Level 3: Financial instruments valued using valuation techniques where one or more significant inputs are based on unobservable market data.

# Notes to the consolidated financial statements continued

## 30. Financial risk management continued

### (g) Fair value analysis continued

Our level 3 derivative financial instruments include cross-currency swaps with an embedded call option, currency swaps where the currency forward curve is illiquid and inflation linked swaps where the inflation curve is illiquid. In valuing these instruments a third-party valuation is obtained to support each reported fair value.

Our level 3 commodity contracts primarily consist of our forward purchases of electricity and gas where pricing inputs are unobservable, as well as other complex transactions. Complex transactions can introduce the need for internally developed models based on reasonable assumptions. Industry standard valuation techniques such as the Black-Scholes pricing model and Monte Carlo simulation are used for valuing such instruments. Level 3 is also applied in cases when optionality is present or where an extrapolated forward curve is considered unobservable. All published forward curves are verified to market data; if forward curves differ from market data by 5% or more they are considered unobservable.

The changes in value of our level 3 derivative financial instruments are as follows:

| | Derivative financial instruments | | Commodity contracts | | Total | |
|---|---|---|---|---|---|---|
| | **2014 Level 3 valuation £m** | 2013 Level 3 valuation £m | **2014 Level 3 valuation £m** | 2013 Level 3 valuation £m | **2014 Level 3 valuation £m** | 2013 Level 3 valuation £m |
| At 1 April | **(104)** | (180) | **(71)** | (140) | **(175)** | (320) |
| Net gains/(losses) for the year[1,2] | **7** | 79 | **19** | 45 | **26** | 124 |
| Purchases | **–** | – | **1** | (14) | **1** | (14) |
| Settlements | **(3)** | (3) | **(7)** | 39 | **(10)** | 36 |
| Reclassification out of level 3 | **–** | – | **–** | (1) | **–** | (1) |
| **At 31 March** | **(100)** | (104) | **(58)** | (71) | **(158)** | (175) |

1. Gain of £7m (2013: £79m gain) is attributable to derivative financial instruments held at the end of the reporting period.
2. Loss of £30m (2013: £51m gain) is attributable to commodity contract financial instruments held at the end of the reporting period.

In 2014 the transfers out of level 3 were immaterial.

The impacts on a post-tax basis of reasonably possible changes in significant level 3 assumptions are as follows:

| | Derivative financial instruments | | Commodity contracts | |
|---|---|---|---|---|
| | **2014 Income statement £m** | 2013 Income statement £m | **2014 Income statement £m** | 2013 Income statement £m |
| 10% increase in commodity prices[1] | **–** | – | **33** | 40 |
| 10% decrease in commodity prices[1] | **–** | – | **(15)** | (23) |
| Volume forecast uplift[2] | **–** | – | **(2)** | (4) |
| Volume forecast reduction[2] | **–** | – | **2** | 4 |
| Forward curve extrapolation | **–** | – | **1** | – |
| +20 basis point change in LPI market curve[3] | **(54)** | (62) | **–** | – |
| –20 basis point change in LPI market curve[3] | **53** | 60 | **–** | – |

1. Level 3 commodity price sensitivity is included within the sensitivity analysis disclosed in note 33 on page 147.
2. Volumes were flexed using maximum and minimum historical averages, or by >10% where historical averages were not available.
3. A reasonably possible change in assumption of other level 3 derivative financial instruments is unlikely to result in a material change in fair values.

The impacts disclosed above were considered on a contract by contract basis with the most significant unobservable inputs identified.

## 31. Borrowing facilities

To support our long-term liquidity requirements and provide backup to commercial paper and other borrowings, we agree loan facilities with financial institutions over and above the value of borrowings that may be required. These facilities have never been drawn, and our undrawn amounts are listed below.

At 31 March 2014, we had bilateral committed credit facilities of £2,073m (2013: £2,009m). In addition, we had committed credit facilities from syndicates of banks of £800m at 31 March 2014 (2013: £877m). All committed credit facilities were undrawn in 2014 and 2013. An analysis of the maturity of these undrawn committed facilities is shown below:

| | 2014 £m | 2013 £m |
|---|---|---|
| Undrawn committed borrowing facilities expiring: | | |
| Less than 1 year | – | – |
| In 1-2 years | 800 | 1,140 |
| In 2-3 years | – | 877 |
| In 3-4 years | 853 | – |
| In 4-5 years | 1,220 | 869 |
| | 2,873 | 2,886 |

Of the unused facilities at 31 March 2014, £2,583m (2013: £2,568m) was held as backup to commercial paper and similar borrowings, while £290m (2013: £318m) is available as backup to specific US borrowings.

Further information on our bonds can be found on the debt investor section of our website.

# Notes to the consolidated financial statements continued

## 32. Subsidiary undertakings, joint ventures and associates

While we present consolidated results in these financial statements as if we were one company, our legal structure is such that there are a number of different operating and holding companies that contribute to the overall result. This structure has evolved through acquisitions as well as regulatory requirements to have certain activities within separate legal entities.

### Principal subsidiary undertakings

The principal subsidiary undertakings included in the consolidated financial statements at 31 March 2014 are listed below. These undertakings are wholly owned and, unless otherwise indicated, are incorporated in England and Wales.

| | Principal activity |
|---|---|
| National Grid Gas plc | Transmission and distribution of gas |
| National Grid Electricity Transmission plc | Transmission of electricity |
| New England Power Company[1] | Transmission of electricity |
| Massachusetts Electric Company[1] | Distribution of electricity |
| The Narragansett Electric Company[1] | Transmission and distribution of electricity |
| Niagara Mohawk Power Corporation[1] | Transmission of electricity and distribution of electricity and gas |
| National Grid Metering Limited | Metering services |
| National Grid Grain LNG Limited | LNG importation and storage |
| National Grid Interconnectors Limited | Electricity interconnector operator |
| Boston Gas Company[1] | Distribution of gas |
| National Grid Generation LLC[1] | Generation of electricity |
| KeySpan Gas East Corporation[1] | Distribution of gas |
| The Brooklyn Union Gas Company[1] | Distribution of gas |
| NGG Finance plc | Financing |
| National Grid Property Holdings Limited | Property services |
| National Grid Holdings One plc | Holding company |
| Lattice Group plc | Holding company |
| National Grid USA[1] | Holding company |
| Niagara Mohawk Holdings, Inc.[1] | Holding company |
| National Grid Commercial Holdings Limited | Holding company |
| National Grid Holdings Limited | Holding company |
| KeySpan Corporation[1] | Holding company |
| National Grid North America Inc.[1] | Holding company |
| British Transco Finance Inc.[1] | Financing |
| British Transco International Finance BV (incorporated in the Netherlands) | Financing |

1. Incorporated in the US.

### Principal joint ventures and associates

The principal joint ventures and associated undertakings included in the financial statements at 31 March 2014 are listed below. These undertakings are incorporated in England and Wales (unless otherwise indicated).

| | % of ordinary shares held | Principal activity |
|---|---|---|
| BritNed Development Limited | 50 | UK-Netherlands interconnector |
| NGET/SPT Upgrades Limited | 50 | England-Scotland interconnector |
| Millennium Pipeline Company, LLC[1] | 26.25 | Transmission of gas |
| Iroquois Gas Transmission System, L.P.[1] | 20.4 | Transmission of gas |

1. Incorporated in the US.

The Group comprises a large number of entities and it is not practical to include all of them in this list. This list therefore includes brief details for those principal companies which in the Directors' opinion have a significant impact on the revenue, profit or assets of the Group. A full list of subsidiaries, joint ventures and associates is annexed to the Company's Annual Return filed with the Registrar of Companies.

Our interests and activities are held or operated through subsidiaries, branches, joint arrangements or associates established in, and subject to the laws and regulations of, a number of different jurisdictions.

## 33. Sensitivities on areas of estimation and uncertainty

In order to give a clearer picture of the impact on our results or financial position of potential changes in significant estimates and assumptions, the following sensitivities are presented. These sensitivities are hypothetical, as they are based on assumptions and conditions prevailing at the year end, and should be used with caution. The effects provided are not necessarily indicative of the actual effects that would be experienced because our actual exposures are constantly changing.

The sensitivities in the table below show the potential impact in the income statement (and consequential impact on net assets) for a range of different variables which each have been considered in isolation (ie with all other variables remaining constant). There are a number of these sensitivities which are mutually exclusive and therefore if one were to happen, another would not, meaning a total showing how sensitive our results are to these external factors is not meaningful.

We are further required to show additional sensitivity analysis for changes in interest and exchange rates and these are shown separately in the table below due to the additional assumptions that are made in order to produce meaningful sensitivity disclosures.

The sensitivities included in the table below all have an equal and opposite effect if the sensitivity increases or decreases by the same amount unless otherwise stated. For example a 10% increase in unbilled revenue at 31 March 2014 would result in a decrease in the income statement of £58m and a 10% decrease in unbilled revenue would have the equal but opposite effect.

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | **Income statement £m** | **Net assets £m** | Income statement £m | Net assets £m |
| One year average change in economic useful lives (pre-tax) | | | | |
| Depreciation charge on property, plant and equipment | **68** | **68** | 68 | 68 |
| Amortisation charge on intangible assets | **18** | **18** | 15 | 15 |
| Estimated future cash flows in respect of provisions change of 10% (pre-tax) | **164** | **164** | 176 | 176 |
| Assets and liabilities carried at fair value change of 10% (pre-tax) | | | | |
| Derivative financial instruments[1] | **81** | **81** | 56 | 56 |
| Commodity contract liabilities | **4** | **4** | 5 | 5 |
| Pensions and other post-retirement benefits[2] (pre-tax) | | | | |
| UK discount rate change of 0.5%[3] | **13** | **1,347** | 12 | 1,460 |
| US discount rate change of 0.5%[3] | **15** | **473** | 12 | 568 |
| UK RPI rate change of 0.5%[4] | **12** | **1,217** | 12 | 1,185 |
| UK long-term rate of increase in salaries change of 0.5%[5] | **5** | **95** | 5 | 128 |
| US long-term rate of increase in salaries change of 0.5%[5] | **4** | **39** | 5 | 43 |
| UK change of one year to life expectancy at age 65 | **3** | **548** | 3 | 597 |
| US change of one year to life expectancy at age 65 | **12** | **220** | 11 | 197 |
| Assumed US healthcare cost trend rates change of 1% | **28** | **355** | 29 | 416 |
| Unbilled revenue at 31 March change of 10% (post-tax) | **58** | **58** | 77 | 77 |
| No hedge accounting for our derivative financial instruments (post-tax) | **350** | **(294)** | (184) | 106 |
| Commodity risk[6] (post-tax) | | | | |
| Commodity prices +10% | **50** | **50** | 45 | 45 |
| Commodity prices –10% | **(33)** | **(33)** | (34) | (34) |
| Financial risk[7] (post-tax) | | | | |
| UK RPI rate change of 0.5%[8] | **26** | **–** | 25 | – |
| UK interest rates change of 0.5% | **93** | **68** | 98 | 90 |
| US interest rates change of 0.5% | **70** | **13** | 87 | 16 |
| US dollar exchange rate change of 10% | **55** | **641** | 65 | 600 |

1. The effect of a 10% change in fair value assumes no hedge accounting.
2. The changes shown are a change in the annual pension or other post-retirement benefit costs and change in the defined benefits obligations.
3. A change in the discount rate is likely to occur as a result of changes in bond yields and as such would be expected to be offset to a significant degree by a change in the value of the bond assets held by the plans.
4. The projected impact resulting from a change in RPI reflects the underlying effect on pensions in payment, pensions in deferment and resultant increases in salary assumptions.
5. This change has been applied to both the pre 1 April 2013 and post 1 April 2013 rate of increase in salary assumption.
6. Represents potential impact on fair values of commodity contracts only.
7. The impact on net assets does not reflect the exchange translation in our US subsidiary net assets. It is estimated this would change by £781m (2013: £712m) in the opposite direction if the dollar exchange rate changed by 10%.
8. Excludes sensitivities to LPI index. Further details on sensitivities are provided in note 30 (g) on page 143.

With the adoption of IAS 19 (revised), we have reviewed the pension assumptions that we consider key (as shown on page 136), and as a result have changed the sensitivities presented in the table above.

# Notes to the consolidated financial statements continued

## 33. Sensitivities on areas of estimation and uncertainty continued

### Pensions and other post-retirement benefits assumptions

Sensitivities have been prepared to show how the DB obligations and annual service costs could potentially be impacted by changes in the relevant actuarial assumptions that were reasonably possible as at 31 March 2014. In preparing sensitivities the potential impact has been calculated by applying the change to each assumption in isolation and assuming all other assumptions remain unchanged. This is with the exception of RPI in the UK where the corresponding effect on pensions in payment, pensions in deferment and resultant increases in salary are recognised.

Following the adoption of IAS 19 (revised) the pension sensitivities have been reviewed. The rate of change has been amended in respect of the impact of discount rate, and life expectancy is now shown as at age 65 (as opposed to age 60). A new sensitivity has been introduced for the impact of UK RPI. The impacts of salaries and US healthcare trend rates remain unchanged. Comparatives for each sensitivity have been presented on a consistent basis. The introduction of a new assumption in the UK for increases in salary for service from 1 April 2013 is reflected in the sensitivity analysis.

### Financial instruments assumptions

Our financial instruments are sensitive to changes in market variables, being UK and US interest rates, the UK RPI and the dollar to sterling exchange rate. The changes in market variables affect the valuation of our borrowings, deposits, derivative financial instruments and commodity contracts. The analysis illustrates the sensitivity of our financial instruments to the changes in market variables.

The following main assumptions were made in calculating the sensitivity analysis:

- the amount of net debt, the ratio of fixed to floating interest rates of the debt and derivatives portfolio, and the proportion of financial instruments in foreign currencies are all constant and on the basis of the hedge designations in place at 31 March 2014 and 2013 respectively;
- the statement of financial position sensitivity to interest rates relates only to derivative financial instruments and available-for-sale investments, as debt and other deposits are carried at amortised cost and so their carrying value does not change as interest rates move;
- the sensitivity of accrued interest to movements in interest rates is calculated on net floating-rate exposures on debt, deposits and derivative instruments;
- changes in the carrying value of derivatives from movements in interest rates of designated cash flow hedges are assumed to be recorded fully within equity; and
- changes in the carrying value of derivative financial instruments designated as net investment hedges from movements in interest rates are recorded in the income statement as they are designated using the spot rather than the forward translation method. The impact of movements in the dollar to sterling exchange rate are recorded directly in equity.

## 34. Additional disclosures in respect of guaranteed securities

We have three debt issuances (including preferred shares) that are listed on a US national securities exchange and are guaranteed by other companies in the Group. These guarantors commit to honour any liabilities should the company issuing the debt have any financial difficulties. In order to provide debt holders with information on the financial stability of the companies providing the guarantees, we are required to disclose individual financial information for these companies. We have chosen to include this information in the Group financial statements rather than submitting separate stand-alone financial statements.

The following condensed consolidating financial information, comprising statements of comprehensive income, statements of financial position and cash flow statements, is given in respect of National Grid Gas plc (subsidiary guarantor), which became joint full and unconditional guarantor on 11 May 2004 with National Grid plc (parent guarantor) of the 6.625% Guaranteed Notes due 2018 issued in June 1998 by British Transco Finance Inc., then known as British Gas Finance Inc. (issuer of notes). Condensed consolidating financial information is also provided in respect of Niagara Mohawk Power Corporation as a result of National Grid plc's guarantee, dated 29 October 2007, of Niagara Mohawk's 3.6% and 3.9% issued preferred shares. National Grid Gas plc, British Transco Finance Inc., and Niagara Mohawk Power Corporation are wholly-owned subsidiaries of National Grid plc.

The following financial information for National Grid plc, National Grid Gas plc, British Transco Finance Inc., and Niagara Mohawk Power Corporation on a condensed consolidating basis is intended to provide investors with meaningful and comparable financial information and is provided pursuant to various rules including Rule 3-10 of Regulation S-X in lieu of the separate financial statements of each subsidiary issuer of public debt securities.

This financial information should be read in conjunction with the other disclosures in these financial statements.

## 34. Additional disclosures in respect of guaranteed securities continued

Summary statements of comprehensive income are presented, on a consolidating basis, for the three years ended 31 March 2014. Summary statements of comprehensive income of National Grid plc and National Grid Gas plc are presented under IFRS measurement principles, as modified by the inclusion of the results of subsidiary undertakings on the basis of equity accounting principles.

The summary statements of financial position of National Grid plc and National Grid Gas plc include the investments in subsidiaries recorded on the basis of equity accounting principles for the purposes of presenting condensed consolidating financial information under IFRS. The summary statements of financial position present these investments within non-current financial and other investments.

The consolidation adjustments column includes the necessary amounts to eliminate the intercompany balances and transactions between National Grid plc, National Grid Gas plc, British Transco Finance Inc., Niagara Mohawk Power Corporation and other subsidiaries.

### Summary statements of comprehensive income for the year ended 31 March 2014 – IFRS

| | Parent guarantor | Issuer of notes | | Subsidiary guarantor | | | |
|---|---|---|---|---|---|---|---|
| | National Grid plc £m | Niagara Mohawk Power Corporation £m | British Transco Finance Inc. £m | National Grid Gas plc £m | Other subsidiaries £m | Consolidation adjustments £m | National Grid consolidated £m |
| **Revenue** | 4 | 2,185 | – | 3,141 | 9,653 | (174) | 14,809 |
| Operating costs | | | | | | | |
| Depreciation and amortisation | – | (127) | – | (529) | (760) | – | (1,416) |
| Payroll costs | – | (278) | – | (251) | (903) | – | (1,432) |
| Purchases of electricity | – | (647) | – | – | (817) | – | (1,464) |
| Purchases of gas | – | (194) | – | (112) | (1,449) | – | (1,755) |
| Rates and property tax | – | (137) | – | (241) | (585) | – | (963) |
| Balancing Service Incentive Scheme | – | – | – | – | (872) | – | (872) |
| Payments to other UK network owners | – | – | – | – | (630) | – | (630) |
| Other operating costs | 15 | (440) | – | (661) | (1,630) | 174 | (2,542) |
| | 15 | (1,823) | – | (1,794) | (7,646) | 174 | (11,074) |
| **Operating profit** | 19 | 362 | – | 1,347 | 2,007 | – | 3,735 |
| Net finance costs | (128) | (85) | – | (285) | (517) | – | (1,015) |
| Dividends receivable | – | – | – | – | 600 | (600) | – |
| Interest in equity accounted affiliates | 2,550 | – | – | 11 | 28 | (2,561) | 28 |
| **Profit before tax** | 2,441 | 277 | – | 1,073 | 2,118 | (3,161) | 2,748 |
| Taxation | 35 | (97) | – | 3 | (225) | – | (284) |
| **Profit for the year** | 2,476 | 180 | –[1] | 1,076 | 1,893 | (3,161) | 2,464 |
| Amounts recognised in other comprehensive income[2] | 235 | (8) | – | 9 | 383 | (384) | 235 |
| **Total comprehensive income for the year** | **2,711** | **172** | **–** | **1,085** | **2,276** | **(3,545)** | **2,699** |
| Attributable to: | | | | | | | |
| Equity shareholders | 2,711 | 172 | – | 1,085 | 2,288 | (3,545) | 2,711 |
| Non-controlling interests | – | – | – | – | (12) | – | (12) |
| | **2,711** | **172** | **–** | **1,085** | **2,276** | **(3,545)** | **2,699** |

1. Profit for the year for British Transco Finance Inc. is £nil as interest payable to external bond holders is offset by interest receivable on loans to National Grid Gas plc.
2. Includes other comprehensive income relating to interest in equity accounted affiliates.

# Notes to the consolidated financial statements continued

## 34. Additional disclosures in respect of guaranteed securities continued

### Summary statements of comprehensive income for the year ended 31 March 2013 – IFRS

| | Parent guarantor | Issuer of notes | | Subsidiary guarantor | | | |
|---|---|---|---|---|---|---|---|
| | National Grid plc (restated)[1] £m | Niagara Mohawk Power Corporation (restated)[1] £m | British Transco Finance Inc. (restated)[1] £m | National Grid Gas plc (restated)[1] £m | Other subsidiaries (restated)[1] £m | Consolidation adjustments (restated)[1] £m | National Grid consolidated (restated)[1] £m |
| **Revenue** | – | 2,129 | – | 3,062 | 9,345 | (177) | 14,359 |
| Operating costs | | | | | | | |
| Depreciation and amortisation | – | (119) | – | (511) | (731) | – | (1,361) |
| Payroll costs | – | (276) | – | (238) | (942) | – | (1,456) |
| Purchases of electricity | – | (561) | – | – | (579) | – | (1,140) |
| Purchases of gas | – | (151) | – | (128) | (1,036) | – | (1,315) |
| Rates and property tax | – | (141) | – | (235) | (593) | – | (969) |
| Balancing Service Incentive Scheme | – | – | – | – | (805) | – | (805) |
| Payments to other UK network owners | – | – | – | – | (487) | – | (487) |
| Other operating costs | – | (357) | – | (579) | (2,318) | 177 | (3,077) |
| | – | (1,605) | – | (1,691) | (7,491) | 177 | (10,610) |
| **Operating profit** | – | 524 | – | 1,371 | 1,854 | – | 3,749 |
| Net finance costs | (181) | (88) | – | (274) | (513) | – | (1,056) |
| Dividends receivable | – | – | – | – | 1,900 | (1,900) | – |
| Interest in equity accounted affiliates | 2,295 | – | – | 8 | 18 | (2,303) | 18 |
| **Profit before tax** | 2,114 | 436 | – | 1,105 | 3,259 | (4,203) | 2,711 |
| Taxation | 39 | (168) | – | (174) | (254) | – | (557) |
| **Profit for the year** | 2,153 | 268 | –[2] | 931 | 3,005 | (4,203) | 2,154 |
| Amounts recognised in other comprehensive income[3] | (381) | (35) | – | 3 | (353) | 385 | (381) |
| **Total comprehensive income for the year** | **1,772** | **233** | **–** | **934** | **2,652** | **(3,818)** | **1,773** |
| Attributable to: | | | | | | | |
| Equity shareholders | 1,772 | 233 | – | 934 | 2,651 | (3,818) | 1,772 |
| Non-controlling interests | – | – | – | – | 1 | – | 1 |
| | **1,772** | **233** | **–** | **934** | **2,652** | **(3,818)** | **1,773** |

1. See note 1 on page 92.
2. Profit for the year for British Transco Finance Inc. is £nil as interest payable to external bond holders is offset by interest receivable on loans to National Grid Gas plc.
3. Includes other comprehensive income relating to interest in equity accounted affiliates.

# 34. Additional disclosures in respect of guaranteed securities continued

## Summary statements of comprehensive income for the year ended 31 March 2012 – IFRS

| | Parent guarantor | Issuer of notes | | Subsidiary guarantor | | | |
|---|---|---|---|---|---|---|---|
| | National Grid plc (restated)[1] £m | Niagara Mohawk Power Corporation (restated)[1] £m | British Transco Finance Inc. (restated)[1] £m | National Grid Gas plc (restated)[1] £m | Other subsidiaries (restated)[1] £m | Consolidation adjustments (restated)[1] £m | National Grid consolidated (restated)[1] £m |
| **Revenue** | – | 2,269 | – | 2,909 | 8,828 | (174) | 13,832 |
| Operating costs | | | | | | | |
| Depreciation and amortisation | – | (115) | – | (491) | (666) | – | (1,272) |
| Payroll costs | – | (267) | – | (228) | (968) | – | (1,463) |
| Purchases of electricity | – | (530) | – | – | (915) | – | (1,445) |
| Purchases of gas | – | (169) | – | (133) | (1,221) | – | (1,523) |
| Rates and property tax | – | (137) | – | (236) | (582) | – | (955) |
| Balancing Service Incentive Scheme | – | – | – | – | (818) | – | (818) |
| Payments to other UK network owners | – | – | – | – | (407) | – | (407) |
| Other operating costs | 1 | (502) | – | (492) | (1,595) | 174 | (2,414) |
| | 1 | (1,720) | – | (1,580) | (7,172) | 174 | (10,297) |
| **Operating profit** | 1 | 549 | – | 1,329 | 1,656 | – | 3,535 |
| Net finance costs | (133) | (97) | – | (400) | (530) | – | (1,160) |
| Dividends receivable | – | – | – | – | 350 | (350) | – |
| Interest in equity accounted affiliates | 2,022 | – | – | 5 | 7 | (2,027) | 7 |
| **Profit before tax** | 1,890 | 452 | – | 934 | 1,483 | (2,377) | 2,382 |
| Taxation | 27 | (187) | – | (102) | (201) | – | (463) |
| **Profit for the year** | 1,917 | 265 | –[2] | 832 | 1,282 | (2,377) | 1,919 |
| Amounts recognised in other comprehensive income[3] | (763) | (33) | – | 9 | (773) | 797 | (763) |
| **Total comprehensive income for the year** | **1,154** | **232** | **–** | **841** | **509** | **(1,580)** | **1,156** |
| Attributable to: | | | | | | | |
| Equity shareholders | 1,154 | 232 | – | 841 | 507 | (1,580) | 1,154 |
| Non-controlling interests | – | – | – | – | 2 | – | 2 |
| | **1,154** | **232** | **–** | **841** | **509** | **(1,580)** | **1,156** |

1. See note 1 on page 92.
2. Profit for the year for British Transco Finance Inc. is £nil as interest payable to external bond holders is offset by interest receivable on loans to National Grid Gas plc.
3. Includes other comprehensive income relating to interest in equity accounted affiliates.

# Notes to the consolidated financial statements continued

## 34. Additional disclosures in respect of guaranteed securities continued

### Statements of financial position as at 31 March 2014 – IFRS

| | Parent guarantor | Issuer of notes | | Subsidiary guarantor | | | |
|---|---|---|---|---|---|---|---|
| | National Grid plc £m | Niagara Mohawk Power Corporation £m | British Transco Finance Inc. £m | National Grid Gas plc £m | Other subsidiaries £m | Consolidation adjustments £m | National Grid consolidated £m |
| **Non-current assets** | | | | | | | |
| Goodwill | – | 581 | – | – | 4,013 | – | 4,594 |
| Other intangible assets | – | – | – | 230 | 439 | – | 669 |
| Property, plant and equipment | – | 4,266 | – | 12,259 | 20,654 | – | 37,179 |
| Other non-current assets | – | 26 | – | 15 | 46 | – | 87 |
| Amounts owed by subsidiary undertakings | 305 | – | 180 | 5,609 | 2,676 | (8,770) | – |
| Pension assets | – | – | – | – | 174 | – | 174 |
| Financial and other investments | 14,520 | 22 | – | 50 | 9,896 | (23,853) | 635 |
| Derivative financial assets | 643 | – | – | 642 | 272 | – | 1,557 |
| Total non-current assets | 15,468 | 4,895 | 180 | 18,805 | 38,170 | (32,623) | 44,895 |
| **Current assets** | | | | | | | |
| Inventories and current intangible assets | – | 27 | – | 24 | 217 | – | 268 |
| Trade and other receivables | 3 | 572 | – | 361 | 1,855 | 64 | 2,855 |
| Amounts owed by subsidiary undertakings | 9,025 | 11 | 5 | 262 | 11,100 | (20,403) | – |
| Financial and other investments | 1,481 | 10 | – | 420 | 1,688 | – | 3,599 |
| Derivative financial assets | 284 | – | – | 63 | 174 | (108) | 413 |
| Cash and cash equivalents | 24 | 16 | – | – | 314 | – | 354 |
| Total current assets | 10,817 | 636 | 5 | 1,130 | 15,348 | (20,447) | 7,489 |
| **Total assets** | **26,285** | **5,531** | **185** | **19,935** | **53,518** | **(53,070)** | **52,384** |
| **Current liabilities** | | | | | | | |
| Borrowings | (1,327) | (328) | (4) | (568) | (1,284) | – | (3,511) |
| Derivative financial liabilities | (286) | – | – | (99) | (62) | 108 | (339) |
| Trade and other payables | (37) | (252) | – | (809) | (1,933) | – | (3,031) |
| Amounts owed to subsidiary undertakings | (8,695) | (56) | – | (2,212) | (9,440) | 20,403 | – |
| Current tax liabilities | – | (64) | – | (27) | (13) | (64) | (168) |
| Provisions | – | – | – | (74) | (208) | – | (282) |
| Total current liabilities | (10,345) | (700) | (4) | (3,789) | (12,940) | 20,447 | (7,331) |
| **Non-current liabilities** | | | | | | | |
| Borrowings | (1,850) | (1,321) | (180) | (6,048) | (13,040) | – | (22,439) |
| Derivative financial liabilities | (154) | – | – | (279) | (391) | – | (824) |
| Other non-current liabilities | – | (245) | – | (1,045) | (551) | – | (1,841) |
| Amounts owed to subsidiary undertakings | (2,022) | – | – | (654) | (6,094) | 8,770 | – |
| Deferred tax liabilities | (3) | (609) | – | (1,601) | (1,869) | – | (4,082) |
| Pension and other post-retirement benefit obligations | – | (652) | – | – | (1,933) | – | (2,585) |
| Provisions | – | (243) | – | (158) | (962) | – | (1,363) |
| Total non-current liabilities | (4,029) | (3,070) | (180) | (9,785) | (24,840) | 8,770 | (33,134) |
| **Total liabilities** | **(14,374)** | **(3,770)** | **(184)** | **(13,574)** | **(37,780)** | **29,217** | **(40,465)** |
| **Net assets** | **11,911** | **1,761** | **1** | **6,361** | **15,738** | **(23,853)** | **11,919** |
| **Equity** | | | | | | | |
| Share capital | 439 | 112 | – | 45 | 182 | (339) | 439 |
| Share premium account | 1,336 | 1,808 | – | 204 | 8,032 | (10,044) | 1,336 |
| Retained earnings | 14,895 | (159) | 1 | 4,814 | 7,628 | (12,284) | 14,895 |
| Other equity reserves | (4,759) | – | – | 1,298 | (112) | (1,186) | (4,759) |
| **Shareholders' equity** | **11,911** | **1,761** | **1** | **6,361** | **15,730** | **(23,853)** | **11,911** |
| Non-controlling interests | – | – | – | – | 8 | – | 8 |
| **Total equity** | **11,911** | **1,761** | **1** | **6,361** | **15,738** | **(23,853)** | **11,919** |

# 34. Additional disclosures in respect of guaranteed securities continued

## Statements of financial position as at 31 March 2013 – IFRS

| | Parent guarantor | Issuer of notes | | Subsidiary guarantor | | | |
|---|---|---|---|---|---|---|---|
| | National Grid plc (restated)[1] £m | Niagara Mohawk Power Corporation (restated)[1] £m | British Transco Finance Inc. £m | National Grid Gas plc £m | Other subsidiaries (restated)[1] £m | Consolidation adjustments (restated)[1] £m | National Grid consolidated (restated)[1] £m |
| **Non-current assets** | | | | | | | |
| Goodwill | – | 737 | – | – | 4,291 | – | 5,028 |
| Other intangible assets | – | – | – | 199 | 390 | – | 589 |
| Property, plant and equipment | – | 4,441 | – | 12,122 | 20,029 | – | 36,592 |
| Other non-current assets | – | 21 | – | 12 | 71 | – | 104 |
| Amounts owed by subsidiary undertakings | 295 | – | – | 5,609 | 2,043 | (7,947) | – |
| Pension assets | – | 195 | – | – | – | – | 195 |
| Financial and other investments | 12,167 | 21 | – | 43 | 9,896 | (21,478) | 649 |
| Derivative financial assets | 585 | – | – | 977 | 410 | – | 1,972 |
| Total non-current assets | 13,047 | 5,415 | – | 18,962 | 37,130 | (29,425) | 45,129 |
| **Current assets** | | | | | | | |
| Inventories and current intangible assets | – | 28 | – | 22 | 241 | – | 291 |
| Trade and other receivables | 3 | 428 | – | 380 | 2,099 | – | 2,910 |
| Amounts owed by subsidiary undertakings | 9,470 | 18 | 202 | 202 | 12,250 | (22,142) | – |
| Financial and other investments | 2,385 | 32 | – | 854 | 2,160 | – | 5,431 |
| Derivative financial assets | 163 | – | – | 119 | 60 | (69) | 273 |
| Cash and cash equivalents | 338 | 9 | – | 20 | 304 | – | 671 |
| Total current assets | 12,359 | 515 | 202 | 1,597 | 17,114 | (22,211) | 9,576 |
| **Total assets** | **25,406** | **5,930** | **202** | **20,559** | **54,244** | **(51,636)** | **54,705** |
| **Current liabilities** | | | | | | | |
| Borrowings | (613) | (69) | (4) | (1,103) | (1,659) | – | (3,448) |
| Derivative financial liabilities | (228) | – | – | (86) | (162) | 69 | (407) |
| Trade and other payables | (44) | (132) | – | (590) | (2,285) | – | (3,051) |
| Amounts owed to subsidiary undertakings | (9,029) | (70) | – | (3,152) | (9,891) | 22,142 | – |
| Current tax liabilities | – | (59) | – | (26) | (146) | – | (231) |
| Provisions | – | – | – | (63) | (245) | – | (308) |
| Total current liabilities | (9,914) | (330) | (4) | (5,020) | (14,388) | 22,211 | (7,445) |
| **Non-current liabilities** | | | | | | | |
| Borrowings | (2,762) | (1,798) | (198) | (6,247) | (13,642) | – | (24,647) |
| Derivative financial liabilities | (458) | – | – | (420) | (396) | – | (1,274) |
| Other non-current liabilities | – | (281) | – | (1,053) | (550) | – | (1,884) |
| Amounts owed to subsidiary undertakings | (2,042) | – | – | – | (5,905) | 7,947 | – |
| Deferred tax liabilities | (1) | (562) | – | (1,817) | (1,697) | – | (4,077) |
| Pension and other post-retirement benefit obligations | – | (980) | – | – | (2,712) | – | (3,692) |
| Provisions | – | (268) | – | (121) | (1,063) | – | (1,452) |
| Total non-current liabilities | (5,263) | (3,889) | (198) | (9,658) | (25,965) | 7,947 | (37,026) |
| **Total liabilities** | **(15,177)** | **(4,219)** | **(202)** | **(14,678)** | **(40,353)** | **30,158** | **(44,471)** |
| **Net assets** | **10,229** | **1,711** | **–** | **5,881** | **13,891** | **(21,478)** | **10,234** |
| **Equity** | | | | | | | |
| Share capital | 433 | 123 | – | 45 | 182 | (350) | 433 |
| Share premium account | 1,344 | 1,930 | – | 204 | 7,426 | (9,560) | 1,344 |
| Retained earnings | 13,133 | (342) | – | 4,325 | 6,471 | (10,454) | 13,133 |
| Other equity reserves | (4,681) | – | – | 1,307 | (193) | (1,114) | (4,681) |
| **Shareholders' equity** | **10,229** | **1,711** | **–** | **5,881** | **13,886** | **(21,478)** | **10,229** |
| Non-controlling interests | – | – | – | – | 5 | – | 5 |
| **Total equity** | **10,229** | **1,711** | **–** | **5,881** | **13,891** | **(21,478)** | **10,234** |

1. See note 1 on page 92.

# Notes to the consolidated financial statements continued

## 34. Additional disclosures in respect of guaranteed securities continued

### Cash flow statements

| | Parent guarantor | Issuer of notes | | Subsidiary guarantor | | | |
|---|---|---|---|---|---|---|---|
| | National Grid plc £m | Niagara Mohawk Power Corporation £m | British Transco Finance Inc. £m | National Grid Gas plc £m | Other subsidiaries £m | Consolidation adjustments £m | National Grid consolidated £m |
| **Year ended 31 March 2014** | | | | | | | |
| Net cash flow from operating activities | 52 | 581 | – | 1,717 | 1,669 | – | 4,019 |
| Net cash flow from/(used in) investing activities | 1,358 | (555) | – | (91) | (993) | (1,049) | (1,330) |
| Net cash flow (used in)/from financing activities | (1,724) | (18) | – | (1,632) | (647) | 1,049 | (2,972) |
| **Net (decrease)/increase in cash and cash equivalents in the year** | **(314)** | **8** | **–** | **(6)** | **29** | **–** | **(283)** |
| **Year ended 31 March 2013** | | | | | | | |
| Net cash flow from operating activities | 36 | 162 | – | 1,608 | 1,944 | – | 3,750 |
| Net cash flow used in investing activities | (979) | (286) | – | (1,345) | (1,048) | (2,472) | (6,130) |
| Net cash flow from/(used in) financing activities | 1,255 | 132 | – | (240) | (904) | 2,472 | 2,715 |
| Net increase/(decrease) in cash and cash equivalents in the year | 312 | 8 | – | 23 | (8) | – | 335 |
| **Year ended 31 March 2012** | | | | | | | |
| Net cash flow from operating activities | 75 | 441 | – | 1,596 | 2,116 | – | 4,228 |
| Net cash flow from/(used in) investing activities | 559 | (287) | – | (1,171) | (1,166) | (306) | (2,371) |
| Net cash flow (used in)/from financing activities | (808) | (155) | – | (502) | (741) | 306 | (1,900) |
| Net (decrease)/increase in cash and cash equivalents in the year | (174) | (1) | – | (77) | 209 | – | (43) |

Cash dividends were received by National Grid plc from subsidiary undertakings amounting to £1,050m during the year ended 31 March 2014 (2013: £570m; 2012: £200m).

### Maturity analysis of parent Company borrowings

| | **2014 £m** | 2013 £m |
|---|---|---|
| Total borrowings are repayable as follows: | | |
| Less than 1 year | **1,327** | 613 |
| In 1-2 years | **46** | 835 |
| In 2-3 years | **580** | 51 |
| In 3-4 years | **–** | 642 |
| In 4-5 years | **506** | – |
| More than 5 years | **718** | 1,234 |
| | **3,177** | 3,375 |

# Company accounting policies

We are required to include the stand-alone balance sheet of our ultimate parent Company, National Grid plc, under the Companies Act 2006. This is because the publicly traded shares are those of National Grid plc and the following disclosures provide additional information to shareholders.

## A. Basis of preparation of individual financial statements under UK GAAP

These individual financial statements of the Company have been prepared in accordance with applicable UK accounting and financial reporting standards and the Companies Act 2006. They have been prepared on an historical cost basis, except for the revaluation of financial instruments, and are presented in pounds sterling, which is the currency of the primary economic environment in which the Company operates. The 2013 comparative financial information has also been prepared on this basis.

These individual financial statements have been prepared on a going concern basis following the assessment made by the Directors as set out on page 52.

The Company has not presented its own profit and loss account as permitted by section 408 of the Companies Act 2006.

The Company has taken advantage of the exemptions in FRS 8 'Related Party Disclosures' from disclosing transactions with other members of the National Grid plc group of companies.

In accordance with exemptions under FRS 29 'Financial Instruments: Disclosures', the Company has not presented the financial instruments disclosures required by the standard, as disclosures which comply with the standard are included in the consolidated financial statements.

## B. Fixed asset investments

Investments held as fixed assets are stated at cost less any provisions for impairment. Investments are reviewed for impairment if events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairments are calculated such that the carrying value of the fixed asset investment is the lower of its cost or recoverable amount. Recoverable amount is the higher of its net realisable value and its value-in-use.

## C. Taxation

Current tax for the current and prior periods is provided at the amount expected to be paid or recovered using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or the right to pay less tax, at a future date, at tax rates expected to apply when the timing differences reverse based on tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements.

Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

## D. 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 balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at closing exchange rates. Gains and losses arising on retranslation of monetary assets and liabilities are included in the profit and loss account.

## E. Financial instruments

The Company's accounting policies under UK GAAP, namely FRS 25 'Financial Instruments: Presentation', FRS 26 'Financial Instruments: Measurement' and FRS 29 'Financial Instruments: Disclosures', are the same as the Group's accounting policies under IFRS, namely IAS 32 'Financial Instruments: Presentation', IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 7 'Financial Instruments: Disclosures'. The Company applies these policies only in respect of the financial instruments that it has, namely investments, derivative financial instruments, debtors, cash at bank and in hand, borrowings and creditors.

The policies are set out in notes 13, 15, 17, 18, 19 and 20 to the consolidated financial statements. The Company is taking the exemption for financial instruments disclosures, because IFRS 7 disclosures are given in notes 30 and 33 to the consolidated financial statements.

## F. Hedge accounting

The Company applies the same accounting policy as the Group in respect of fair value hedges and cash flow hedges. This policy is set out in note 15 to the consolidated financial statements.

## G. Parent Company guarantees

The Company has guaranteed the repayment of the principal sum, any associated premium and interest on specific loans due by certain subsidiary undertakings primarily to third parties. In the event of default or non performance by the subsidiary, the Company recognises such guarantees as insurance contracts, at fair value with a corresponding increase in the carrying value of the investment.

## H. Share awards to employees of subsidiary undertakings

The issuance by the Company to employees of its subsidiaries of a grant over the Company's options represents additional capital contributions by the Company to its subsidiaries. An additional investment in subsidiaries results in a corresponding increase in shareholders' equity. The additional capital contribution is based on the fair value of the option at the date of grant, allocated over the underlying grant's vesting period. Where payments are subsequently received from subsidiaries, these are accounted for as a return of a capital contribution and credited against the Company's investments in subsidiaries. The Company has no employees.

## I. Dividends

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

# Company balance sheet
## at 31 March

| | Notes | 2014 £m | 2013 £m |
|---|---|---|---|
| **Fixed assets** | | | |
| Investments | 1 | **8,803** | 8,177 |
| **Current assets** | | | |
| Debtors (amounts falling due within one year) | 2 | **9,312** | 9,636 |
| Debtors (amounts falling due after more than one year) | 2 | **948** | 880 |
| Investments | 5 | **1,504** | 2,723 |
| Cash at bank and in hand | | **1** | – |
| **Total current assets** | | **11,765** | 13,239 |
| **Creditors (amounts falling due within one year)** | 3 | **(10,345)** | (9,914) |
| **Net current assets** | | **1,420** | 3,325 |
| **Total assets less current liabilities** | | **10,223** | 11,502 |
| **Creditors (amounts falling due after more than one year)** | 3 | **(4,029)** | (5,263) |
| **Net assets** | | **6,194** | 6,239 |
| **Capital and reserves** | | | |
| Called up share capital | 7 | **439** | 433 |
| Share premium account | 8 | **1,336** | 1,344 |
| Cash flow hedge reserve | 8 | **20** | 12 |
| Available-for-sale reserve | 8 | **1** | – |
| Other equity reserves | 8 | **260** | 240 |
| Profit and loss account | 8 | **4,138** | 4,210 |
| **Total shareholders' funds** | 9 | **6,194** | 6,239 |

The notes on pages 157 to 159 form part of the individual financial statements of the Company, which were approved by the Board of Directors on 18 May 2014 and were signed on its behalf by:

**Sir Peter Gershon** Chairman
**Andrew Bonfield** Finance Director

# Notes to the Company financial statements

## 1. Fixed asset investments

| | Shares in subsidiary undertakings £m |
|---|---|
| At 1 April 2012 | 8,157 |
| Additions | 20 |
| At 31 March 2013 | 8,177 |
| Additions | 626 |
| **At 31 March 2014** | **8,803** |

During the year there was a capital contribution of £20m (2013: £20m) which represents the fair value of equity instruments granted to subsidiaries' employees arising from equity-settled employee share schemes. On 27 March 2014, the Company also acquired a further 98,851 ordinary shares of £1 each in National Grid (US) Holdings Limited for a total consideration of £606m.

The names of the principal subsidiary undertakings, joint ventures and associates are included in note 32 to the consolidated financial statements. The Directors believe that the carrying value of the investments is supported by the fair value of their underlying net assets.

## 2. Debtors

| | 2014 £m | 2013 £m |
|---|---|---|
| **Amounts falling due within one year** | | |
| Derivative financial instruments (note 4) | **284** | 163 |
| Amounts owed by subsidiary undertakings | **9,025** | 9,470 |
| Prepayments and accrued income | **3** | 3 |
| | **9,312** | 9,636 |
| **Amounts falling due after more than one year** | | |
| Derivative financial instruments (note 4) | **643** | 585 |
| Amounts owed by subsidiary undertakings | **305** | 295 |
| | **948** | 880 |

The carrying values stated above are considered to represent the fair values of the assets.

## 3. Creditors

| | 2014 £m | 2013 £m |
|---|---|---|
| **Amounts falling due within one year** | | |
| Borrowings (note 6) | **1,327** | 613 |
| Derivative financial instruments (note 4) | **286** | 228 |
| Amounts owed to subsidiary undertakings | **8,695** | 9,029 |
| Other creditors | **37** | 44 |
| | **10,345** | 9,914 |
| **Amounts falling due after more than one year** | | |
| Borrowings (note 6) | **1,850** | 2,762 |
| Derivative financial instruments (note 4) | **154** | 458 |
| Amounts owed to subsidiary undertakings | **2,022** | 2,042 |
| Deferred taxation | **3** | 1 |
| | **4,029** | 5,263 |

The carrying values stated above are considered to represent the fair values of the liabilities.

| | Deferred taxation £m |
|---|---|
| At 1 April 2012 | (1) |
| Charged to the profit and loss account | 1 |
| Charged to equity | 1 |
| At 31 March 2013 | 1 |
| Charged to the profit and loss account | 1 |
| Charged to equity | 1 |
| **At 31 March 2014** | **3** |

# Notes to the Company financial statements continued

## 4. Derivative financial instruments
The fair values of derivative financial instruments are:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | Assets £m | Liabilities £m | Total £m | Assets £m | Liabilities £m | Total £m |
| Amounts falling due within one year | 284 | (286) | (2) | 163 | (228) | (65) |
| Amounts falling due after more than one year | 643 | (154) | 489 | 585 | (458) | 127 |
| | 927 | (440) | 487 | 748 | (686) | 62 |

For each class of derivative the notional contract* amounts are as follows:

| | 2014 £m | 2013 £m |
|---|---|---|
| Interest rate swaps | (6,531) | (8,015) |
| Cross-currency interest rate swaps | (4,490) | (5,376) |
| Foreign exchange forward contracts | (11,626) | (9,080) |
| **Total** | (22,647) | (22,471) |

*The notional contract amounts of derivatives indicate the gross nominal value of transactions outstanding at the balance sheet date.

## 5. Investments
The following table sets out the Company's current asset investments:

| | 2014 £m | 2013 £m |
|---|---|---|
| Investments in short-term money funds | 1,238 | 2,113 |
| Short-term deposits | 245 | 438 |
| Restricted cash balances – collateral | 21 | 172 |
| | 1,504 | 2,723 |

## 6. Borrowings
The following table analyses the Company's total borrowings:

| | 2014 £m | 2013 £m |
|---|---|---|
| **Amounts falling due within one year** | | |
| Bank loans | 423 | 277 |
| Bonds | 904 | 336 |
| | 1,327 | 613 |
| **Amounts falling due after more than one year** | | |
| Bonds | 1,850 | 2,762 |
| **Total borrowings** | 3,177 | 3,375 |

The maturity of total borrowings is disclosed in note 34 to the consolidated financial statements. There are no differences in the maturities as calculated under IFRS or UK GAAP.

The notional amount of borrowings outstanding as at 31 March 2014 was £3,074m (2013: £3,250m). Further information on significant borrowings can be found on the debt investors section of our website.

## 7. Called up share capital
The called up share capital amounting to £439m (2013: £433m) consists of 3,854,339,684 (2013: 3,794,575,998) ordinary shares. For further information on share capital, refer to note 24 to the consolidated financial statements.

## 8. Reserves

| | Share premium account £m | Cash flow hedge reserve £m | Available-for-sale reserve £m | Other equity reserves £m | Profit and loss account £m |
|---|---|---|---|---|---|
| At 1 April 2012 | 1,355 | 9 | – | 220 | 4,579 |
| Transferred from equity in respect of cash flow hedges (net of tax) | – | 3 | – | – | – |
| Shares issued in lieu of dividends | (11) | – | – | – | – |
| Issue of treasury shares | – | – | – | – | 19 |
| Purchase of own shares | – | – | – | – | (6) |
| Share awards to employees of subsidiary undertakings | – | – | – | 20 | – |
| Loss for the financial year | – | – | – | – | (382) |
| At 31 March 2013 | 1,344 | 12 | – | 240 | 4,210 |
| Transferred from equity in respect of cash flow hedges (net of tax) | – | 8 | – | – | – |
| Net gains taken to equity | – | – | 1 | – | – |
| Shares issued in lieu of dividends | (8) | – | – | – | – |
| Issue of treasury shares | – | – | – | – | 14 |
| Purchase of own shares | – | – | – | – | (3) |
| Share awards to employees of subsidiary undertakings | – | – | – | 20 | – |
| Loss for the financial year | – | – | – | – | (83) |
| **At 31 March 2014** | **1,336** | **20** | **1** | **260** | **4,138** |

There were no gains and losses, other than losses for the years stated above; therefore no separate statement of total recognised gains and losses has been presented. At 31 March 2014, £86m (2013: £86m) of the profit and loss account reserve relating to gains on intra-group transactions was not distributable to shareholders.

## 9. Reconciliation of movements in total shareholders' funds

| | **2014 £m** | 2013 £m |
|---|---|---|
| Profit for the financial year | **976** | 428 |
| Dividends[1] | **(1,059)** | (810) |
| Loss for the financial year | **(83)** | (382) |
| Issue of treasury shares | **14** | 19 |
| Purchase of own shares | **(3)** | (6) |
| Shares issued in lieu of dividends[2] | **(2)** | – |
| Movement on cash flow hedge reserve (net of tax) | **8** | 3 |
| Movement on available-for-sale reserve | **1** | – |
| Share awards to employees of subsidiary undertakings | **20** | 20 |
| Net decrease in shareholders' funds | **(45)** | (346) |
| Opening shareholders' funds | **6,239** | 6,585 |
| **Closing shareholders' funds** | **6,194** | 6,239 |

1. For further details of dividends paid and payable to shareholders, refer to note 8 to the consolidated financial statements.
2. Included within share premium account are costs associated with scrip dividends.

## 10. Parent Company guarantees

The Company has guaranteed the repayment of the principal sum, any associated premium and interest on specific loans due by certain subsidiary undertakings primarily to third parties. At 31 March 2014, the sterling equivalent amounted to £2,713m (2013: £2,767m). The guarantees are for varying terms from less than one year to open-ended.

## 11. Audit fees

The audit fee in respect of the parent Company was £26,750 (2013: £25,750). Fees payable to PricewaterhouseCoopers LLP for non-audit services to the Company are included within note 3 (e) to the consolidated financial statements.

nationalgrid

# National Grid USA and Subsidiaries

Consolidated Financial Statements

For the years ended March 31, 2014 and 2013

**NATIONAL GRID USA AND SUBSIDIARIES**

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### Independent Auditor's Report

To the Shareholders and Board of Directors
of National Grid USA

We have audited the accompanying consolidated financial statements of National Grid USA (the "Company"), which comprise the consolidated balance sheets as of March 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, cash flows, capitalization, and changes in shareholders' equity for the years then ended.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

***Auditor's Responsibility***

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of National Grid USA at March 31, 2014 and 2013, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

October 24, 2014

*PricewaterhouseCoopers LLP, 300 Madison Avenue, New York, NY 10017*
*T: (646) 471 3000, F: (646) 471 8320, www.pwc.com/us*

## NATIONAL GRID USA AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF INCOME
*(in millions of dollars)*

| | Years Ended March 31, | |
|---|---|---|
| | **2014** | 2013 |
| **Operating revenues:** | | |
| Electric services | **$ 7,177** | $ 6,525 |
| Gas distribution | **5,355** | 4,784 |
| Other | **24** | 28 |
| Total operating revenues | **12,556** | 11,337 |
| **Operating expenses:** | | |
| Purchased electricity | **2,503** | 2,059 |
| Purchased gas | **2,360** | 2,013 |
| Operations and maintenance | **4,541** | 4,280 |
| Depreciation and amortization | **896** | 854 |
| Other taxes | **1,063** | 1,055 |
| Total operating expenses | **11,363** | 10,261 |
| **Operating income** | **1,193** | 1,076 |
| **Other income and (deductions):** | | |
| Interest on long-term debt | **(400)** | (389) |
| Other interest, including affiliate interest | **(47)** | (25) |
| Equity income in unconsolidated subsidiaries | **35** | 36 |
| Other deductions, net | **(18)** | (10) |
| Total other deductions, net | **(430)** | (388) |
| **Income before income taxes** | **763** | 688 |
| **Income tax expense** | **277** | 272 |
| **Income from continuing operations** | **486** | 416 |
| Net income (loss) from discontinued operations, net of taxes | **133** | (14) |
| **Net income** | **619** | 402 |
| Net loss attributable to non-controlling interest | **20** | 1 |
| Dividends paid on preferred stock | **(597)** | (578) |
| **Net income (loss) attributable to common shares** | **$ 42** | $ (175) |

The accompanying notes are an integral part of these consolidated financial statements.

**NATIONAL GRID USA AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
*(in millions of dollars)*

| | Years Ended March 31, 2014 | Years Ended March 31, 2013 |
|---|---|---|
| Net income | **$ 619** | $ 402 |
| Other comprehensive income (loss): | | |
| Unrealized gains on securities, net of $3 and $0 tax expense | **4** | 1 |
| Unrealized losses on hedges, net of $1 and $1 tax benefit | **(2)** | (2) |
| Change in pension and other postretirement obligations, net of $103 tax expense and $73 tax benefit | **145** | (117) |
| Adjustment for establishment of Narragansett pension tracker, net of $0 $54 tax expense | **-** | 91 |
| Reclassification of gains into net income, net of $45 and $61 tax expense | **67** | 87 |
| Other comprehensive income | **214** | 60 |
| Comprehensive income | **833** | 462 |
| Less: comprehensive loss attributable to non-controlling interest | **20** | 1 |
| Comprehensive income attributable to National Grid USA | **$ 853** | $ 463 |

The accompanying notes are an integral part of these consolidated financial statements.

## NATIONAL GRID USA AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF CASH FLOWS
*(in millions of dollars)*

| | Years Ended March 31, 2014 | 2013 |
|---|---|---|
| **Operating activities:** | | |
| Net income | **$ 619** | $ 402 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | **896** | 854 |
| Regulatory amortizations | **50** | 265 |
| Provision for deferred income taxes | **255** | 427 |
| Bad debt expense | **136** | 59 |
| Equity income in unconsolidated subsidiaries, net of dividends received | **(10)** | (13) |
| Allowance for equity funds used during construction | **(27)** | (21) |
| Amortization of debt discount and issuance costs | **10** | 12 |
| Net pension and other postretirement expense (contributions) | **113** | (48) |
| Net environmental remediation payments | **(136)** | (125) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable and other receivable, net, and unbilled revenues | **(718)** | (821) |
| Accounts receivable from/payable to affiliates, net | **(49)** | 245 |
| Inventory | **45** | 101 |
| Regulatory assets and liabilities, net | **45** | 118 |
| Derivative contracts | **22** | (98) |
| Prepaid and accrued taxes | **(33)** | (166) |
| Accounts payable and other liabilities | **-** | (16) |
| Other, net | **7** | 93 |
| Net cash provided by operating activities | **1,225** | 1,268 |
| **Investing activities:** | | |
| Capital expenditures | **(1,960)** | (1,806) |
| Net proceeds from disposal of subsidiary assets | **-** | 294 |
| Changes in restricted cash and special deposits | **53** | (41) |
| Cost of removal and other | **(206)** | (201) |
| Net cash used in investing activities | **(2,113)** | (1,754) |
| **Financing activities:** | | |
| Dividends paid on common and preferred stock | **(597)** | (578) |
| Payments on long-term debt | **(304)** | (95) |
| Proceeds from long-term debt | **-** | 1,047 |
| Commercial paper (paid) issued | **(204)** | 625 |
| Advances from affiliates | **2,171** | (500) |
| Equity infusion from Parent | **1,000** | - |
| Other | **34** | 62 |
| Net cash provided by financing activities | **2,100** | 561 |
| Net increase in cash and cash equivalents | **1,212** | 75 |
| Net cashflow from discontinued operations - operating | **(352)** | (168) |
| Net cashflow from discontinued operations - investing | **28** | (18) |
| Cash and cash equivalents, beginning of year | **683** | 794 |
| Cash and cash equivalents, end of year | **$ 1,571** | $ 683 |
| **Supplemental disclosures:** | | |
| Interest paid | $ (457) | $ (365) |
| Income taxes paid | (108) | (94) |
| **Significant non-cash items:** | | |
| Capital-related accruals included in accounts payable | 161 | 84 |
| Long Island Power Authority settlement | 371 | - |

The accompanying notes are an integral part of these consolidated financial statements.

**NATIONAL GRID USA AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**
*(in millions of dollars)*

| | March 31, 2014 | March 31, 2013 |
|---|---|---|
| **ASSETS** | | |
| **Current assets:** | | |
| Cash and cash equivalents | **$ 1,571** | $ 683 |
| Restricted cash and special deposits | **168** | 221 |
| Accounts receivable | **2,761** | 2,206 |
| Allowance for doubtful accounts | **(300)** | (296) |
| Other receivable | **58** | 67 |
| Accounts receivable from affiliates | **2** | 13 |
| Unbilled revenues | **620** | 592 |
| Inventory | **344** | 355 |
| Regulatory assets | **571** | 313 |
| Derivative contracts | **70** | 61 |
| Current portion of deferred income tax assets | **171** | 193 |
| Prepaid taxes | **145** | 177 |
| Prepaid and other current assets | **125** | 142 |
| Current assets related to discontinued operations | **153** | 423 |
| Total current assets | **6,459** | 5,150 |
| **Equity investments** | **194** | 184 |
| **Property, plant, and equipment, net** | | |
| Property, plant, and equipment, net | **23,875** | 22,499 |
| Property, plant, and equipment, net related to discontinued operations | **-** | 28 |
| Total property, plant, and equipment, net | **23,875** | 22,527 |
| **Other non-current assets:** | | |
| Regulatory assets | **4,322** | 4,590 |
| Goodwill | **7,151** | 7,151 |
| Derivative contracts | **26** | 14 |
| Postretirement benefits asset | **305** | 297 |
| Financial investments | **476** | 427 |
| Other | **141** | 124 |
| Other non-current assets related to discontinued operations | **29** | 28 |
| Total other non-current assets | **12,450** | 12,631 |
| **Total assets** | **$ 42,978** | $ 40,492 |

The accompanying notes are an integral part of these consolidated financial statements.

**NATIONAL GRID USA AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**
*(in millions of dollars)*

| | March 31, | |
|---|---|---|
| | **2014** | 2013 |
| **LIABILITIES AND CAPITALIZATION** | | |
| **Current liabilities:** | | |
| Accounts payable | **$ 1,339** | $ 1,372 |
| Accounts payable to affiliates | **63** | 123 |
| Advances from affiliates | **2,171** | - |
| Other tax liabilities | **35** | 34 |
| Commercial paper | **421** | 625 |
| Current portion of long-term debt | **633** | 263 |
| Taxes accrued | **21** | 102 |
| Customer deposits | **98** | 104 |
| Interest accrued | **134** | 160 |
| Regulatory liabilities | **524** | 412 |
| Derivative contracts | **43** | 11 |
| Payroll and benefits accruals | **228** | 272 |
| Other | **279** | 171 |
| Current liabilities related to discontinued operations | **37** | 173 |
| Total current liabilities | **6,026** | 3,822 |
| **Other non-current liabilities:** | | |
| Regulatory liabilities | **2,688** | 2,605 |
| Asset retirement obligations | **87** | 105 |
| Deferred income tax liabilities | **4,850** | 4,238 |
| Postretirement benefits | **2,872** | 3,639 |
| Environmental remediation costs | **1,341** | 1,370 |
| Derivative contracts | **14** | 64 |
| Other | **892** | 948 |
| Other non-current liabilities related to discontinued operations | **-** | 155 |
| Total other non-current liabilities | **12,744** | 13,124 |
| **Commitments and contingencies (Note 13)** | | |
| **Capitalization:** | | |
| Shareholders' equity | **16,000** | 14,731 |
| Long-term debt | **8,208** | 8,815 |
| **Total capitalization** | **24,208** | 23,546 |
| **Total liabilities and capitalization** | **$ 42,978** | $ 40,492 |

The accompanying notes are an integral part of these consolidated financial statements.

## NATIONAL GRID USA AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF CAPITALIZATION
*(in millions of dollars)*

| | | | March 31, 2014 | March 31, 2013 |
|---|---|---|---|---|
| Shareholders' equity attributable to common and preferred shares | | | **$ 15,988** | $ 14,705 |
| Non-controlling interest in subsidiaries | | | **12** | 26 |
| Long-term debt: | Interest Rate | Maturity Date | | |
| European Medium Term Note | Variable | June 2014 - January 2016 | **842** | 876 |
| Notes Payable | 3.30% - 9.75% | October 2014 - December 2042 | **5,948** | 6,113 |
| Gas Facilities Revenue Bonds | Variable | December 2020 - July 2026 | **230** | 230 |
| Gas Facilities Revenue Bonds | 4.7% - 6.95% | April 2020 - July 2026 | **411** | 411 |
| First Mortgage Bonds | 6.34% - 9.63% | April 2018 - April 2028 | **127** | 128 |
| State Authority Financing Bonds | Variable | October 2015 - August 2042 | **1,153** | 1,199 |
| Industrial Development Revenue Bonds | 5.25% | June 2027 | **128** | 128 |
| Total debt | | | **8,839** | 9,085 |
| Unamortized debt premium (discount) | | | **2** | (7) |
| Current portion of long-term debt | | | **(633)** | (263) |
| Long-term debt | | | **8,208** | 8,815 |
| **Total capitalization** | | | **$ 24,208** | $ 23,546 |

The accompanying notes are an integral part of these consolidated financial statements.

# NATIONAL GRID USA AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
*(in millions of dollars, except per share and number of shares data)*

| | Common Stock | Preferred Stock | Cumulative Preferred Stock | Additional Paid-in Capital | Accumulated Other Comprehensive Income (Loss): Unrealized Gain (Loss) on Available for Sale Securities | Pension and Postretirement Benefits | Hedging Activity | Total Accumulated Other Comprehensive Income (Loss) | Retained Earnings | Non-controlling Interest | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Balance as of March 31, 2012** | **$ -** | **$ -** | **$ 35** | **$ 13,046** | **$ (3)** | **$ (925)** | **$ 2** | **$ (926)** | **$ 2,601** | **$ 9** | **$ 14,765** |
| Net income | - | - | - | - | - | - | - | - | 403 | (1) | 402 |
| Other comprehensive income (loss): | | | | | | | | | | | |
| Unrealized gains on securities, net of $0 tax expense | - | - | - | - | 1 | - | - | 1 | - | - | 1 |
| Unrealized losses on hedges, net of $1 tax benefit | - | - | - | - | - | - | (2) | (2) | - | - | (2) |
| Change in pension and other postretirement obligations, net of $73 tax benefit | - | - | - | - | - | (117) | - | (117) | - | - | (117) |
| Adjustment for establishment of Narragansett pension tracker, net of $54 tax expense | - | - | - | - | - | 91 | - | 91 | - | - | 91 |
| Reclassification of gains into net income, net of $61 tax expense | - | - | - | - | - | 87 | - | 87 | - | - | 87 |
| Total comprehensive income | | | | | | | | | | | 462 |
| Consolidation of variable interest entity | - | - | - | - | - | - | - | - | - | 22 | 22 |
| Other equity transactions with non-controlling interest | - | - | - | - | - | - | - | - | - | (4) | (4) |
| Share based compensation | - | - | - | 64 | - | - | - | - | - | - | 64 |
| Dividends on preferred stock | - | - | - | - | - | - | - | - | (578) | - | (578) |
| **Balance as of March 31, 2013** | **$ -** | **$ -** | **$ 35** | **$ 13,110** | **$ (2)** | **$ (864)** | **$ -** | **$ (866)** | **$ 2,426** | **$ 26** | **$ 14,731** |
| Net income | - | - | - | - | - | - | - | - | 639 | (20) | 619 |
| Other comprehensive income (loss): | | | | | | | | | | | |
| Unrealized gains on securities, net of $3 tax expense | - | - | - | - | 4 | - | - | 4 | - | | 4 |
| Unrealized losses on hedges, net of $1 tax benefit | - | - | - | - | - | - | (2) | (2) | - | - | (2) |
| Change in pension and other postretirement obligations, net of $103 tax expense | - | - | - | - | - | 145 | - | 145 | - | - | 145 |
| Reclassification of gains into net income, net of $45 tax expense | - | - | - | - | - | 67 | - | 67 | - | - | 67 |
| Total comprehensive income | | | | | | | | | | | 833 |
| Other equity transactions with non-controlling interest | - | - | - | (7) | - | - | - | - | - | 6 | (1) |
| Equity infusion from Parent | - | - | - | 1,000 | - | - | - | - | - | - | 1,000 |
| Parent tax allocation | - | - | - | 1 | - | - | - | - | - | - | 1 |
| Share based compensation | - | - | - | 33 | - | - | - | - | - | - | 33 |
| Dividends on preferred stock | - | - | - | - | - | - | - | - | (597) | - | (597) |
| **Balance as of March 31, 2014** | **$ -** | **$ -** | **$ 35** | **$ 14,137** | **$ 2** | **$ (652)** | **$ (2)** | **$ (652)** | **$ 2,468** | **$ 12** | **$ 16,000** |

The Company had 641 shares of common stock authorized, issued and outstanding, with a par value of $0.10 per share, 915 shares of preferred stock authorized, issued and outstanding, with a par value of $0.10 per share and 372,641 shares of cumulative preferred stock authorized, issued and outstanding, with par values of $100 and $50 per share at March 31, 2014 and 2013.

The accompanying notes are an integral part of these consolidated financial statements.

## NATIONAL GRID USA AND SUBSIDIARIES
## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

National Grid USA ("NGUSA" or "the Company") is a public utility holding company with regulated subsidiaries engaged in the generation of electricity and the transmission, distribution and sale of both natural gas and electricity. NGUSA is a direct wholly-owned subsidiary of National Grid North America Inc. ("NGNA") and an indirect wholly-owned subsidiary of National Grid plc ("Parent"), a public limited company incorporated under the laws of England and Wales.

NGUSA has two major lines of business, "Gas Distribution" and "Electric Services," and operates various energy services and investment companies.

The Company's wholly-owned New England subsidiaries include: New England Power Company ("NEP"), The Narragansett Electric Company ("Narragansett"), Massachusetts Electric Company ("Massachusetts Electric"), Nantucket Electric Company ("Nantucket"), Boston Gas Company ("Boston Gas"), and Colonial Gas Company ("Colonial Gas"). The Company's wholly-owned New York subsidiaries include: Niagara Mohawk Power Corporation ("Niagara Mohawk"), National Grid Generation, LLC ("National Grid Generation"), The Brooklyn Union Gas Company ("Brooklyn Union"), and KeySpan Gas East Corporation ("KeySpan Gas East").

In addition, the Company has certain subsidiaries which have provided operational and energy management services and continue to supply capacity to and produce energy for the use of customers of the Long Island Power Authority ("LIPA"), on Long Island, New York. The services provided to LIPA were or continue to be provided through the following contractual arrangements. The Power Supply Agreement ("PSA") which was amended and restated for a maximum term of 15 years in October 2012 provides LIPA with electric generating capacity, energy conversion and ancillary services from the Company's Long Island generating units. The Energy Management Agreement ("EMA"), which expired on May 28, 2013, provided management of all aspects of fuel supply for the Company's Long Island generating facilities. The Management Service Agreement ("MSA"), which expired on December 31, 2013, provided operation, maintenance and construction services, and significant administrative services relating to the Long Island electric transmission and distribution system. The results of the MSA are reflected as discontinued operations in the accompanying consolidated financial statements for the years ended March 31, 2014 and 2013.

On July 3, 2012, the Company's previous subsidiaries, Granite State Electric Company ("Granite State") and EnergyNorth Natural Gas, Inc., ("EnergyNorth") were sold to Liberty Energy Utilities Co. ("Liberty Energy"), a subsidiary of Algonquin Power & Utilities Corp. The results of Granite State and EnergyNorth are reflected as discontinued operations in the accompanying consolidated statements of income for the year ended March 31, 2013.

*Other Services and Investments*

The Company's Energy Services business includes companies that provide energy-related services to customers located primarily within the northeastern United States. These services comprise the operation, maintenance, and design of energy systems for commercial and industrial customers.

The Company's Energy Investments business consists of gas production and development investments such as natural gas pipelines, as well as certain other domestic energy-related investments. Through the Company's wholly-owned subsidiary, National Grid LNG, it owns a 600,000 barrel liquefied natural gas storage and receiving facility in Providence, Rhode Island. The Company also owns a 53.7% interest in two hydro-transmission electric companies which are consolidated into these financial statements.

The Company's consolidated financial statements also include a 26.25% interest in Millennium Pipeline Company LLC ("Millennium") and a 20.4% interest in Iroquois Gas Transmission System, which are accounted for under the equity method of accounting. In addition, the Company owns an equity ownership interest in three regional nuclear generating companies whose facilities have been decommissioned as discussed in Note 13, "Commitments and Contingencies" under "Decommissioning Nuclear Units."

The Company uses the equity method of accounting for its investments in affiliates when it has the ability to exercise significant influence over the operating and financial policies, but does not control the affiliates. The Company's share of the earnings or losses of such affiliates is included as equity income in unconsolidated subsidiaries in the accompanying consolidated statements of income.

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"), including the accounting principles for rate-regulated entities as applicable. The consolidated financial statements reflect the rate-making practices of the applicable regulatory authorities.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Non-controlling interests of majority-owned subsidiaries are calculated based upon the respective non-controlling interest ownership percentages. All intercompany transactions have been eliminated in consolidation.

Under its holding company structure, the Company has no independent operations or source of income of its own and conducts all of its operations through its subsidiaries. As a result, the Company depends on the earnings and cash flow of, and dividends or distributions from, its subsidiaries to provide the funds necessary to meet its debt and contractual obligations. Furthermore, a substantial portion of the Company's consolidated assets, earnings and cash flow is derived from the operations of its regulated utility subsidiaries, whose legal authority to pay dividends or make other distributions to the Company is subject to regulation by state regulatory authorities.

The Company has evaluated subsequent events and transactions through October 24, 2014, the date of issuance of these consolidated financial statements, and concluded that there were no events or transactions that require adjustment to, or disclosure in, the consolidated financial statements as of and for the year ended March 31, 2014, except as described in Note 4, "Rate Matters" and Note 18, "Subsequent Events."

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Use of Estimates

In preparing consolidated financial statements that conform to U.S. GAAP, the Company must make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, and the disclosure of contingent assets and liabilities included in the consolidated financial statements. Actual results could differ from those estimates.

### Regulatory Accounting

The Federal Energy Regulatory Commission ("FERC"), the New York State Public Service Commission ("NYPSC"), the Massachusetts Department of Public Utilities ("DPU"), and the Rhode Island Public Utilities Commission ("RIPUC") regulate the rates the Company's subsidiaries charge their customers in the applicable states. In these cases, the subsidiaries defer costs (as regulatory assets) or recognize obligations (as regulatory liabilities) if it is probable that such amounts will be recovered from or refunded to customers through future rates. Regulatory assets and liabilities are amortized to the consolidated statements of income consistent with the treatment of the related costs in the rate-making process.

### Revenue Recognition

*Electric and Gas Distribution Revenue*

Revenues are recognized for energy service provided on a monthly billing cycle basis. The Company records unbilled revenues for the estimated amount of services rendered from the time meters were last read to the end of the accounting period.

As approved by state regulators, the Company is allowed to pass through commodity-related costs to customers and also bills for approved rate adjustment mechanisms. In addition, the Company's subsidiaries have revenue decoupling mechanisms which allow for adjustments to the Company's delivery rates as a result of the reconciliation between allowed revenue and billed revenue. Any difference between the allowed revenue and the billed revenue is recorded as a regulatory asset or regulatory liability.

The gas distribution business is influenced by seasonal weather conditions. Brooklyn Union, KeySpan Gas East, Niagara Mohawk and Narragansett gas utility tariffs contain weather normalization adjustments that provide for recovery from, or refund to, customers of material shortfalls or excesses of delivery revenues (revenues less applicable gas costs and revenue taxes) during a heating season due to variations from normal weather.

*Transmission Revenue*

Transmission revenues are generated by NEP, Narragansett, Massachusetts Electric, Nantucket, and Niagara Mohawk. Such revenues are based on a formula rate that recovers actual costs plus a return on investment. Stranded cost recovery revenues are collected through a contract termination charge ("CTC"), which is billed to former wholesale customers of the Company in connection with the Company's divestiture of its electricity generation investments.

*Generation Revenue*

Electric generation revenue is derived from billings to LIPA for the electric generation capacity and, to the extent requested, energy from the Company's existing oil and gas-fired generating plants as discussed in Note 13, "Commitments and Contingencies" under "Electric Services and LIPA Agreements."

*Other Revenues*

Revenues earned for service and maintenance contracts associated with commercial energy systems are recognized as earned or over the life of the service contract, as appropriate.

**Other Taxes**

The Company's subsidiaries collect from customers various taxes that are levied by state or local governments on the sale or distribution of gas. The Company presents taxes that are imposed on customers (such as sales taxes) on a net basis (i.e., excluded from revenues) and presents excise taxes on a gross basis.

Gas distribution revenues include the collection of excise taxes and the related expense is included in other taxes in the accompanying consolidated statements of income.

The state of New York imposes on corporations a franchise tax that is computed as the higher of a tax based on income or a tax based on capital. To the extent the Company's New York state tax based on capital is in excess of the state tax based on income, the Company reports such excess in other taxes and taxes accrued in the accompanying consolidated financial statements.

Narragansett and Niagara Mohawk accrue for property taxes on a calendar year basis, taking into account the assessment period. Narragansett and Niagara Mohawk had prepaid property taxes of $3.4 million and $9.4 million at March 31, 2014 and 2013, respectively.

**Income Taxes**

Federal and state income taxes have been computed utilizing the asset and liability approach that requires the recognition of deferred tax assets and liabilities for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. Deferred income taxes also reflect the tax effect of net operating losses, capital losses and general business credit carryforwards.

The effects of tax positions are recognized in the financial statements when it is more likely than not that the position taken or expected to be taken in a tax return will be sustained upon examination by taxing authorities based on the technical merits of the position. The financial effect of changes in tax laws or rates is accounted for in the period of enactment. Deferred investment tax credits are amortized over the useful life of the underlying property.

NGNA files consolidated federal tax returns including all of the activities of its subsidiaries. Each subsidiary company determines its current and deferred taxes based on the separate return method. The Company settles its current tax liability or benefit each year with NGNA pursuant to a tax sharing arrangement between NGNA and its subsidiaries. Tax benefits attributable to the tax attributes of other group companies and allocated by NGNA are treated as capital contributions.

**Cash and Cash Equivalents**

Cash equivalents consist of short-term, highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at cost which approximates fair value.

**Restricted Cash and Special Deposits**

Restricted cash primarily consists of deposits held by the New York Independent System Operator ("NYISO") and by the ISO New England ("ISO-NE"). Special deposits primarily consist of health care claims deposits. The Company had restricted cash of $144 million and $149 million and special deposits of $24 million and $72 million at March 31, 2014 and 2013 respectively.

**Accounts Receivable and Allowance for Doubtful Accounts**

The Company recognizes an allowance for doubtful accounts to record accounts receivable at estimated net realizable value. During the fiscal year ended March 31, 2014, the Company enhanced its estimation methodology. The allowance is determined based on a variety of factors, including for each type of receivable, applying an estimated reserve percentage to each aging category, taking into account historical collection and write-off experience and management's assessment of collectability from individual customers as appropriate. In prior years, the estimate placed a higher emphasis on write-off history. Management believes the more fulsome analysis of all information disclosed above results in an improved estimate and the updated approach resulted in a decrease of approximately $50.1 million in the reserve. The collectability of receivables is continuously assessed, and if circumstances change, the allowance is adjusted accordingly. Receivable balances are written off against the allowance for doubtful accounts when the accounts are disconnected and/or terminated and the balances are deemed to be uncollectible.

**Inventory**

Inventory is comprised of materials and supplies, gas in storage and renewable energy certificates ("RECs"). Materials and supplies are stated at the lower of weighted average cost or market and are expensed or capitalized as used. The Company's policy is to write-off obsolete inventory; there were no material write-offs of obsolete inventory for the years ended March 31, 2014 or 2013.

Gas in storage is stated at weighted average cost and the related cost is recognized when delivered to customers. Existing rate orders allow the Company to pass directly through to customers, the cost of gas purchased along with any applicable authorized delivery surcharge adjustments. Gas costs passed through to customers are subject to regulatory approvals and are reported periodically to the applicable state regulators.

RECs are used to measure compliance with renewable energy standards and are held primarily for consumption. The Company recorded a compliance liability based on retail electricity sales of $142 million and $99 million within other current liabilities in the accompanying balance sheets at March 31, 2014 and 2013, respectively.

At March 31, 2014 and 2013, the Company had materials and supplies of $178 million and $170 million, respectively, gas in storage of $111 million and $164 million, respectively, and purchased RECs of $55 million and $21 million, respectively.

**Derivatives**

The Company uses derivative instruments to manage commodity price risk, interest and foreign currency rate risk. All derivative instruments are recorded in the accompanying consolidated balance sheets at their fair value. Qualifying derivative instruments may be designated as either cash flow hedges or fair value hedges.

*Commodity Derivative Instruments*

All commodity costs, including the impact of derivative instruments, are passed on to customers through the Company's commodity rate adjustment mechanisms. Therefore, gains or losses on the settlement of these contracts are initially deferred and then refunded to, or collected from, customers consistent with regulatory requirements.

Certain non-trading contracts for the physical purchase of natural gas and electricity qualify for the normal purchase normal sale exception and are accounted for upon settlement. If the Company were to determine that a contract for which it elected the normal purchase normal sale exception no longer qualifies, the Company would recognize the fair value of the contract in accordance with the regulatory accounting described above.

*Financing Derivative Instruments*

Treasury related derivative instruments may qualify as either fair value hedges or cash flow hedges. The Company has entered into cross-currency and interest rate swaps ("CCIRS") to protect against changes in the fair value of fixed-rate borrowings due to movements in market interest rates. The Company has designated these instruments as fair value hedging relationships. For qualifying fair value hedges, all changes in the fair value of the derivative financial instrument and changes in the fair value of the item in relation to the risk being hedged are recognized in the consolidated statements of income. If the hedge relationship is terminated, the fair value adjustment to the hedged item continues to be reported as part of the basis of the item and is amortized to the consolidated statements of income as a yield adjustment over the remainder of the hedging period. At March 31, 2014, the Company held no CCIRS designated in fair value hedging relationships. At March 31, 2013, the Company had a net hedging (swap) asset position of $1 million on $60 million of debt.

The Company continually assesses the cost relationship between fixed and variable rate debt and periodically enters into CCIRS to convert the terms of the underlying debt obligations from fixed rate to variable rate or variable rate to fixed rate. Payments made, or received, on these derivative contracts are recognized as an adjustment to interest expense as incurred. The Company has designated these instruments as cash flow hedges. For qualifying cash flow hedges, the effective portion of a derivative's gain or loss is reported in other comprehensive income, net of related tax effects, and the ineffective portion is reported in earnings. Amounts in accumulated other comprehensive income are reclassified into earnings in the same period or periods during which the hedged transaction affects earnings.

As at March 31, 2014, the Company had $792 million of foreign currency debt and $5.0 million of current derivative assets designated in cash flow hedging relationships, with $4.5 million recognized in other comprehensive income for the year ended March 31, 2014. As at March 31, 2013 the Company had $796.3 million of foreign currency debt and $11 million of current derivative assets and $56 million of non-current derivative liabilities designated in cash flow hedging relationships, with $5 million recognized in other comprehensive income for the year ended March 31, 2013. The Company expects $2.8 million in other comprehensive income will be reclassified into earnings within the next twelve months. For the years ended March 31, 2014 and 2013, the Company recorded ineffectiveness related to cash flow hedges of $2.0 million (loss) and $0.9 million (loss), respectively.

The Company's accounting policy is to not offset fair value amounts recognized for derivative instruments and related cash collateral receivable or payable with the same counterparty under a master netting agreement, and to record and present the fair value of the derivative instrument on a gross basis, with related cash collateral recorded within restricted cash and special deposits in the accompanying consolidated balance sheets. There was no related cash collateral as of March 31, 2014 or 2013 for commodity derivatives. There was zero and $6 million of cash collateral posted for financing derivatives at March 31, 2014 and 2013, respectively.

**Power Purchase Agreements**

Certain of the Company's subsidiaries enter into power purchase agreements to procure commodity to serve their electric service customers. The Company evaluates whether such agreements are leases, derivatives, or executory contracts. Power purchase agreements that do not qualify as leases or derivatives are accounted for as executory contracts and are, therefore, recognized as the electricity is purchased. In making its determination of the accounting for power purchase agreements, the Company considers many factors, including: the source of the electricity; the level of output from any specified facility that the Company is taking under the contract; the involvement, if any, that the Company has in operating the specified facility; and the pricing mechanisms in the contract among other factors.

**Fair Value Measurements**

The Company measures derivatives and available-for-sale securities at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following is the fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities that a company has the ability to access as of the reporting date;
- Level 2: inputs other than quoted prices included within Level 1 that are directly observable for the asset or liability or indirectly observable through corroboration with observable market data; and
- Level 3: unobservable inputs, such as internally-developed forward curves and pricing models for the asset or liability due to little or no market activity for the asset or liability with low correlation to observable market inputs.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The Company uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs.

**Property, Plant and Equipment**

Property, plant and equipment is stated at original cost. The cost of repairs and maintenance is charged to expense and the cost of renewals and betterments that extend the useful life of property, plant and equipment is capitalized. The capitalized cost of additions to property, plant and equipment includes costs such as direct material, labor and benefits, and an allowance for funds used during construction ("AFUDC") for the regulated subsidiaries and capitalized interest for non-regulated projects.

Depreciation is computed over the estimated useful life of the asset using the composite straight-line method. Depreciation studies are conducted periodically to update the composite rates and are approved by the state authorities. The average composite rates and average service lives for the years ended March 31, 2014 and 2013 are as follows:

| | Electric | | Gas | | Common | |
|---|---|---|---|---|---|---|
| | Years Ended March 31, | | Years Ended March 31, | | Years Ended March 31, | |
| | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 |
| Composite rates | **2.8%** | 2.9% | **2.9%** | 2.9% | **5.3%** | 5.2% |
| Average service lives | 48 years | 48 years | **46 years** | 45 years | **36 years** | 38 years |

Depreciation expense for regulated subsidiaries includes a component for estimated future cost of removal, which is recovered through rates charged to customers. Any difference in cumulative costs recovered and costs incurred is recognized as a regulatory liability. When property, plant and equipment is retired, the original cost, less salvage, is charged to accumulated depreciation, and the related cost of removal is removed from the associated regulatory liability. The Company had cumulative costs recovered in excess of costs incurred of $1.6 billion at March 31, 2014 and 2013.

*Allowance for Funds Used During Construction*

In accordance with applicable accounting guidance, the regulated subsidiaries record AFUDC, which represents the debt and equity costs of financing the construction of new property, plant and equipment. AFUDC equity is reported in the consolidated statements of income as non-cash income in other income (deductions), net, and AFUDC debt is reported as a non-cash offset to other interest, including affiliate interest. After construction is completed, the Company is permitted to recover these costs through their inclusion in rate base and corresponding depreciation expense. The Company recorded AFUDC related to equity of $27 million and $21 million for the years ended March 31, 2014 and 2013, respectively. The Company recorded AFUDC related to debt of $13 million and $7 million for the years ended March 31, 2014 and 2013. The average AFUDC rates for the years ended March 31, 2014 and 2013 were 4.5% and 4.1%, respectively.

In addition, approximately $1 million and $8 million of interest was capitalized for construction of non-regulated projects during the years ended March 31, 2014 and 2013, respectively.

**Goodwill and Other Intangible Assets**

*Goodwill*

The Company tests goodwill for impairment annually on January 31, and when events occur or circumstances change that would more likely than not reduce the fair value of each of the Company's respective reporting units below its carrying amount. Goodwill is tested for impairment using a two-step approach. The first step compares the estimated fair value of each reporting unit with its carrying value, including goodwill. If the estimated fair value exceeds the carrying value, then goodwill is considered not impaired. If the carrying value exceeds the estimated fair value, then a second step is performed to determine the implied fair value of goodwill. If the carrying value of goodwill exceeds its implied fair value, then an impairment charge equal to the difference is recorded.

The fair value of each reporting unit was calculated in the annual goodwill impairment test for the year ended March 31, 2014 utilizing both income and market approaches.

- To estimate fair value utilizing the income approach, the Company used a discounted cash flow methodology incorporating its most recent business plan forecasts together with a projected terminal year calculation. Key assumptions used in the income approach were: (a) expected cash flows for the period from April 1, 2014 to March 31, 2019; (b) a discount rate of 5.5%, which was based on the Company's best estimate of its after-tax weighted-average cost of capital; and (c) a terminal growth rate of 2.25%, based on the Company's expected long-term average growth rate in line with estimated long-term U.S. economic inflation.

- To estimate fair value utilizing the market approach, the Company followed a market comparable methodology. Specifically, the Company applied a valuation multiple of earnings before interest, taxes, depreciation and amortization (“EBITDA”), derived from data of publicly-traded benchmark companies, to business operating data. Benchmark companies were selected based on comparability of the underlying business and economics. Key assumptions used in the market approach included the selection of appropriate benchmark companies and the selection of an EBITDA multiple of 10.0, which the Company believes is appropriate based on comparison of its business with the benchmark companies.

The Company determined the fair value of the business using 50% weighting for each valuation methodology, as it believes that each methodology provides equally valuable information. Based on the resulting fair value from the annual analyses, the Company determined that no adjustment of the goodwill carrying value was required at March 31, 2014 or 2013.

*Intangible Assets*

Intangible assets represent finite-lived assets that are amortized over their respective estimated useful lives and, along with other long-lived assets, are evaluated for impairment periodically whenever events or changes in circumstances indicate that their related carrying amounts may not be recoverable.

**Impairment of Long-Lived Assets**

The Company evaluates long-lived assets, including property, plant and equipment and finite-lived intangibles, when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. In evaluating long-lived assets for recoverability, the Company uses its best estimate of future cash flows expected to result from the use of the asset and its eventual disposition. If the estimated future undiscounted net cash flows attributable to the asset are less than the carrying amount, an impairment loss is recognized equal to the difference between the carrying value of such asset and its fair value. Assets to be disposed of and for which there is a committed plan of disposal are reported at the lower of carrying value or fair value less costs to sell.

**Available-For-Sale Securities**

The Company holds available-for-sale securities that include equities, municipal bonds and corporate bonds. These investments are recorded at fair value and are included in other non-current assets in the accompanying consolidated balance sheets. Changes in the fair value of these assets are recorded within other comprehensive income.

**Asset Retirement Obligations**

Asset retirement obligations are recognized for legal obligations associated with the retirement of property, plant, and equipment, primarily associated with the Company’s gas distribution and electric generation facilities. Asset retirement obligations are recorded at fair value in the period in which the obligation is incurred, if the fair value can be reasonably estimated. In the period in which new asset retirement obligations, or changes to the timing or amount of existing retirement obligations are recorded, the associated asset retirement costs are capitalized as part of the carrying amount of the related long-lived asset. In each subsequent period the asset retirement obligation is accreted to its present value.

The Company has a legal obligation to dismantle the Glenwood and Far Rockaway facilities and remediate the associated sites. These facilities were shut down and decommissioning began in July 2012; demolition and remediation activities are expected to be completed between October 2014 and April 2015.

The following table represents the changes in the Company's asset retirement obligations:

| | Years Ended March 31, | |
|---|---|---|
| | **2014** | 2013 |
| | *(in millions of dollars)* | |
| Balance as of the beginning of the year | **$ 105** | $ 119 |
| Accretion expense | **6** | 5 |
| Liabilities settled | **(24)** | (19) |
| Balance as of the end of the year | **$ 87** | $ 105 |

Accretion expense for the Company's regulated subsidiaries is deferred as part of the Company's asset retirement obligation regulatory asset as management believes it is probable that such amounts will be collected in future rates.

**Employee Benefits**

The Company has defined benefit pension and postretirement benefit ("PBOP") plans for its employees. The Company recognizes all pension and PBOP plans' funded status in the accompanying consolidated balance sheets as a net liability or asset with an offsetting adjustment to accumulated other comprehensive income ("AOCI") in shareholders' equity. In the case of regulated entities, the cost of providing these plans is recovered through rates; therefore, the net funded status is offset by a regulatory asset or liability. The Company measures and records its pension and PBOP assets at the year-end date. Pension and PBOP plan assets are measured at fair value, using the year-end market value of those assets.

**Supplemental Executive Retirement Plans**

The Company has corporate assets included in financial investments in the accompanying consolidated balance sheets representing funds designated for Supplemental Executive Retirement Plans. These funds are invested in corporate owned life insurance policies and available-for-sale securities primarily consisting of equity investments and investments in municipal and corporate bonds. The corporate owned life insurance investments are measured at cash surrender value with increases and decreases in the value of these assets recorded in the accompanying consolidated statements of income.

**New and Recent Accounting Guidance**

**Accounting Guidance Adopted in Fiscal Year 2014**

*Offsetting Assets and Liabilities*

In December 2011 and January 2013, the Financial Accounting Standards Board ("FASB") issued amendments to address and clarify the scope of the disclosures related to offsetting assets and liabilities. Under the amendments, reporting entities are required to disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting agreement, such as for derivatives. The instruments and activities subject to these disclosures are recognized derivatives, repurchase and reverse repurchase agreements, and securities lending transactions. The Company adopted this guidance effective April 1, 2013, which only impacted its disclosures.

*Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*

In July 2013, the FASB issued amendments to address diversity in practice related to the presentation of unrecognized tax benefits in certain situations. The amendments require a liability related to an unrecognized tax benefit to be presented on a net basis with its associated deferred tax asset when utilization of such deferred tax assets is required or expected in the event the uncertain tax position is disallowed. Otherwise, the unrecognized tax benefit will be presented as a liability and will not be netted against deferred tax assets. The Company early adopted this guidance effective April 1, 2013 with no material impact on its financial position, results of operations or cash flows.

**Accounting Guidance Not Yet Adopted**

*Reclassifications From Accumulated Other Comprehensive Income*

In February 2013, the FASB issued amendments to improve the reporting of reclassifications out of AOCI. The amendments require an entity to provide information either on the face of the financial statements or in a single footnote on significant amounts reclassified out of AOCI and the related income statement line items to the extent an amount is reclassified in its entirety to net income. For significant items not reclassified to net income in their entirety, an entity is required to cross-reference to other disclosures that provide additional information. For non-public entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2013. Early adoption is permitted. The Company will adopt this guidance effective April 1, 2014, which will only impact its disclosures.

*Revenue Recognition*

In May 2014, the FASB and the International Accounting Standards Board jointly issued a new revenue recognition standard ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." The objective of the new guidance is to provide a single comprehensive revenue recognition model for all contracts with customers to improve comparability. The standard contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services in an amount that reflects the consideration the entity expects to receive. The new guidance must be adopted using either a full retrospective approach or a modified retrospective approach. For non-public entities, the new guidance is effective for periods beginning after December 15, 2017. The Company is currently evaluating the impact of the new guidance on its financial position, results of operations and cash flows.

**Financial Statement Revisions**

During 2014, management determined that certain accounting transactions were not properly recorded in the Company's previously issued consolidated financial statements. The Company corrected the accounting by revising the prior period consolidated financial statements, the key impacts of which are described below. The Company concluded that the revisions were not material to any prior periods.

- Historically, the Company has calculated its capital tracker regulatory asset using its weighted average cost of capital ("WACC") and carrying charges on regulatory assets using its AFUDC rate. The WACC and AFUDC have both a debt and equity component. Accounting standards allow for the capitalization of all or part of an incurred cost that would otherwise be charged to expense if the regulator's actions create probable recovery of those costs through future rates. Because the equity component of a WACC or an AFUDC rate is not an incurred cost that would otherwise be charged to expense, accounting guidance for rate regulated activities does not allow for the capitalization of such equity amounts, and thus, the equity component should not have been included in the Company's capital tracker and carrying charges calculations.

  A cumulative adjustment of $57 million (net of income taxes) was recorded in the consolidated financial statements for the year ended March 31, 2013, of which $58 million was recorded as an adjustment to opening retained earnings (as of March 31, 2012), and $1 million was recorded as an increase to net income within gas distribution revenues, operations and maintenance expense, and other deductions, net for the year ended March 31, 2013 to reflect the fiscal year 2013 activity related to these corrections. This adjustment also resulted in a decrease of $111 million in non-current regulatory assets, a decrease of $17 million in non-current regulatory liabilities and a decrease of $38 million in deferred income tax liabilities as of March 31, 2013.

- During management's review of the Company's allowance for doubtful accounts methodology, management determined it had insufficiently provided for its allowance for doubtful accounts reserve in prior years. A cumulative adjustment of $12 million (net of income taxes) was recorded in the financial statements for the year ended March 31, 2013, of which $9 million was recorded as an adjustment to opening retained earnings (as of March 31, 2012), and $3 million was recorded as a decrease to net income for the year ended March 31, 2013 to reflect the fiscal year 2013 activity related to this correction.

In addition, the Company has corrected various account balances in continuing and discontinued operations that were improperly recorded. A cumulative adjustment of $15 million (net of income taxes) was recorded in the consolidated financial statements for the year ended March 31, 2013, of which $21 million was recorded as an adjustment to opening retained earnings (as of March 31, 2012), and $6 million was recorded as a decrease to net income for the year ended March 31, 2013 to reflect the fiscal year 2013 activity related to these items.

The following tables show the amounts previously reported as revised:

| | As Previously Reported [1] | Discontinued Operations | Adjustments | As Revised |
|---|---|---|---|---|
| | | (in millions of dollars) | | |
| | March 2013 | | | March 2013 |
| **Consolidated Statement of Income** | | | | |
| Operating revenues | $ 12,601 | $ (1,251) | $ (13) | $ 11,337 |
| Operating income | 1,098 | (2) | (20) | 1,076 |
| Other deductions, net | (394) | 7 | (1) | (388) |
| Income before income taxes | 704 | 5 | (21) | 688 |
| Income tax expense | 287 | 9 | (24) | 272 |
| Net loss from discontinued operations, net of taxes | (7) | 4 | (11) | (14) |
| Net income | 410 | (1) | (7) | 402 |
| Net loss attributable to common shares | (167) | - | (8) | (175) |
| | | | | |
| **Consolidated Statement of Cash Flows** | | | | |
| Net cash provided by operating activities | $ 1,100 | $ 182 | $ (14) | $ 1,268 |
| Net cash used in investing activities | (1,770) | 12 | 4 | (1,754) |
| Net cashflow from discontinued operations - operating | 4 | (183) | 11 | (168) |
| Net cashflow from discontinued operations - investing | (5) | (12) | (1) | (18) |

| | As Previously Reported [1] | Discontinued Operations | Adjustments | As Revised |
|---|---|---|---|---|
| | | (in millions of dollars) | | |
| | March 2013 | | | March 2013 |
| **Consolidated Balance Sheet** | | | | |
| Total current assets | $ 5,219 | $ (9) | $ (60) | $ 5,150 |
| Property, plant, and equipment, net | 22,522 | - | 5 | 22,527 |
| Total other non-current assets | 12,746 | 9 | (124) | 12,631 |
| Total current liabilities | 3,826 | - | (4) | 3,822 |
| Total other non-current liabilities | 13,088 | 155 | (119) | 13,124 |
| Long-term debt | 8,970 | (155) | - | 8,815 |
| | | | | |
| Accumulated other comprehensive income (loss) | | | | |
| March 31, 2013 | (864) | - | (2) | (866) |
| March 31, 2012 | (923) | - | (3) | (926) |
| | | | | |
| Retained Earnings | | | | |
| March 31, 2013 | 2,480 | - | (54) | 2,426 |
| March 31, 2012 | 2,647 | - | (46) | 2,601 |

(1) Certain reclassifications have been made to the financial statements to conform prior year data to the current year presentation.

## 3. REGULATORY ASSETS AND LIABILITIES

The Company records regulatory assets and liabilities that result from the rate-making process. The following table presents the regulatory assets and regulatory liabilities recorded in the accompanying consolidated balance sheets.

| | | March 31, | |
|---|---|---|---|
| | | **2014** | 2013 |
| | | *(in millions of dollars)* | |
| **Regulatory assets** | | | |
| Current: | | | |
| | Derivative contracts | **$ 16** | $ 6 |
| | Energy efficiency | **23** | 6 |
| | Gas costs adjustment | **287** | 83 |
| | Rate adjustment mechanisms | **110** | 68 |
| | Renewable energy certificates | **91** | 78 |
| | Revenue decoupling mechanism | **20** | 36 |
| | Other | **24** | 36 |
| | | **571** | 313 |
| Non-current: | | | |
| | Capital tracker | **34** | 30 |
| | Environmental response costs | **1,739** | 1,766 |
| | Postretirement benefits | **1,476** | 1,756 |
| | Recovery of acquisition premium | **208** | 217 |
| | Regulatory deferred tax asset | **134** | 122 |
| | Storm costs | **319** | 342 |
| | Other | **412** | 357 |
| | Total | **4,322** | 4,590 |
| **Regulatory liabilities** | | | |
| Current: | | | |
| | Derivative contracts | **50** | 48 |
| | Energy efficiency | **146** | 122 |
| | Gas costs adjustment | **50** | 91 |
| | Profit sharing | **38** | 43 |
| | Rate adjustment mechanisms | **68** | 74 |
| | Revenue decoupling mechanism | **66** | 25 |
| | Other | **106** | 9 |
| | | **524** | 412 |
| Non-current: | | | |
| | Capital tracker | **39** | 29 |
| | Carrying charges | **60** | 26 |
| | Cost of removal | **1,617** | 1,563 |
| | Delivery rate adjustment | **128** | 130 |
| | Environmental response costs | **104** | 114 |
| | Excess earnings | **95** | 95 |
| | Postretirement benefits | **220** | 315 |
| | Regulatory deferred tax liability | **7** | 24 |
| | Temporary state assessment | **111** | 34 |
| | Other | **307** | 275 |
| | Total | **2,688** | 2,605 |
| | Net regulatory assets | **$ 1,681** | $ 1,886 |

**Capital tracker:** Represents cumulative amounts collected, but not yet spent, to dispose of property, plant and equipment. This liability is discharged as removal costs are incurred.

**Cost of removal:** The Company's depreciation expense includes estimated costs to remove property, plant and equipment, which are recovered through the rates charged to customers. This regulatory liability represents cumulative costs recovered in excess of costs incurred. For a vast majority of its regulated utility plant assets, the Company uses these funds to remove the asset so a new one can be installed in its place.

**Delivery rate adjustment:** The NYPSC authorized a combined annual surcharge for recovery of regulatory assets ("Delivery Rate Surcharge") of $15.0 million in January 2008 and 2009, respectively, for Brooklyn Union and KeySpan Gas East ("The New York Gas Companies"). The annual surcharge increased incrementally by $5.0 million for the first five years of the Brooklyn Union's rate plan and increased by $10.0 million in rate year 2010 through 2012 of KeySpan Gas East's rate plan, aggregating to a total of $175.0 million over the term of the rate agreement. In its order issued and effective November 28, 2012, the NYPSC authorized a Site Investigation and Remediation ("SIR") Surcharge in the amount of $65.0 million which superseded the Delivery Rate Surcharge effective January 1, 2013.

**Derivative contracts (assets and liabilities):** Gains or losses resulting from commodity derivatives are required to be refunded to, or recovered from, customers through the Company's commodity rate adjustment mechanisms. Accordingly, the Company's regulated subsidiaries evaluate open derivative contracts to determine if they are probable of recovery, or refund, through future rates charged to customers and qualify for regulatory deferral. Derivative contracts that qualify for regulatory deferral are recorded at fair value, with changes in fair value recorded as regulatory assets or regulatory liabilities in the period in which the change occurs.

**Energy efficiency**: This amount represents the difference between revenue billed to customers through the Company's energy efficiency charge and the costs of its energy efficiency programs as approved by the state authorities.

**Environmental response costs:** This regulatory asset represents deferred costs associated with the Company's share of the estimated costs to investigate and perform certain remediation activities at sites with which it may be associated. The Company believes future costs, beyond the expiration of current rate plans, will continue to be recovered through rates. The regulatory liability primarily represents the amount of customer contributions and insurance proceeds recovered to pay for costs to investigate and perform certain remediation activities at sites with which it may be associated as well as the excess of amounts received in rates over the Company's actual site investigation and remediation ("SIR") costs.

**Excess earnings:** At the end of each rate year (calendar year), the New York Gas Companies are required to provide the NYPSC with a computation of its return on common equity capital ("ROE"). If the ROE in the applicable rate year exceeds 10.5%, the New York Gas Companies are required to defer a portion of the revenue equivalent associated with any over earnings for the benefit of customers. Beginning January 1, 2013, Brooklyn Union's threshold for earnings sharing has been reduced from 10.5% to 9.4% and the sharing mechanism will be calculated based upon a cumulative average ROE over rate years 2013 and 2014 with 80% of any excess earnings applied as a credit against the SIR deferral balance.

**Gas costs adjustment**: The Company's gas regulated subsidiaries are subject to rate adjustment mechanisms for commodity costs, whereby an asset or liability is recognized resulting from differences between actual revenues and the underlying cost being recovered or differences between actual revenues and targeted amounts as approved by state regulators. These amounts will be refunded to, or recovered from, customers over the next year.

**Postretirement benefits:** The amount in regulatory assets primarily represents the excess costs of the Company's pension and PBOP plans over amounts received in rates that are deferred to a regulatory asset to be recovered in future periods and the non-cash accrual of net actuarial gains and losses. The amount in regulatory liabilities primarily represents accrued carrying charges as calculated in accordance with the Company's pension and PBOP internal reserve mechanism.

**Profit sharing:** This regulatory liability represents a portion of deferred margins from off-system sale transactions. Under current rate orders, Boston Gas and Colonial Gas (the "Massachusetts Gas Companies") are required to return 90% of margins earned from such optimization transactions to firm customers. The amounts deferred in the accompanying balance sheet will be refunded to customers over the next year.

**Rate adjustment mechanisms**: The Company's regulated subsidiaries are subject to a number of rate adjustment mechanisms such as for commodity costs, whereby an asset or liability is recognized resulting from differences between actual revenues and the underlying cost being recovered or differences between actual revenues and targeted amounts as approved by the applicable state regulatory bodies.

**Recovery of acquisition premium:** This represents the unrecovered amount (plus related taxes) by which the purchase price paid exceeded the net book value of Colonial Gas' assets in the 1998 acquisition of Colonial Gas by Eastern Enterprises, Inc. In exchange for certain rate concessions and the achievement of certain merger savings targets, the DPU has allowed Colonial Gas to recover the acquisition premium through rates for the next 25 years (through August 2039).

**Regulatory deferred tax asset (liability):** This amount represents unrecovered federal and state deferred taxes of the Company primarily as a result of regulatory flow through accounting treatment and tax rate changes. The income tax benefits or charges for certain plant related timing differences, such as equity AFUDC, are immediately flowed through to, or collected from, customers. The amortization of the related regulatory deferred tax asset or liability, for these items, follows the book life of the underlying plant asset.

**Renewable energy certificates:** Represents deferred costs associated with the Company's compliance obligation with the Rhode Island and Massachusetts Renewable Portfolio Standard ("RPS"). The RPS is legislation established to foster the development of new renewable energy sources. The regulatory asset will be recovered over the next year.

**Revenue decoupling mechanism**: Revenue decoupling mechanisms allow for the periodic adjustment of delivery rates as a result of the reconciliation between allowed revenue per customer and actual revenue per customer. Any difference between the allowed revenue per customer and the actual revenue per customer is recorded as a regulatory asset or regulatory liability.

**Temporary state assessment:** In June 2009, the NYPSC authorized utilities, including the New York Gas Companies, to recover the costs required for payment of the Temporary State Energy & Utility Service Conservation Assessment ("Temporary State Assessment"), including carrying charges. The Temporary State Assessment is subject to reconciliation over a five year period beginning July 1, 2009 and ending June 30, 2014. On June 18, 2014, the NYPSC issued an order authorizing certain utilities, including the New York Gas Companies, to recover the Temporary State Assessment subject to reconciliation, including carrying charges, from July 1, 2014 through June 30, 2017. As of May 31, 2014, the New York Gas Companies over-collected on these costs. The New York Gas Companies are required to net any deferred over-collected amounts against the amount to be collected during fiscal years 2014 and 2015 as well as the first payment relating to fiscal years 2015 and 2016.

**Storm costs:** This regulatory asset represents the incremental operation and maintenance costs to restore power to customers resulting from major storms.

The Company records carrying charges on all regulatory balances, with the exception of derivative contracts, cost of removal, environmental response costs, renewable energy certificates, and regulatory deferred tax balances, where cash expenditures have been made and are subject to recovery, or for which cash has been collected and is subject to refund. Carrying charges are not recorded on items for which expenditures have not yet been made.

## 4. RATE MATTERS

### Niagara Mohawk

*March 2013 Electric and Gas Filing*

In March 2013 the NYPSC issued a final order regarding Niagara Mohawk's electric and gas base rate filing made on April 27, 2012. The term of the new rate plan is from April 1, 2013 through March 31, 2016 and provides for an electric revenue requirement of $1,338 million in the first year, $1,396 million in the second year, and $1,443 million in the third year. It also provides for a gas revenue requirement of $307 million in the first year, $315 million in the second year, and $322 million in the third year.

*Transmission Return on Equity Complaint*

On September 11, 2012, the New York Association of Public Power ("NYAPP") filed a complaint against Niagara Mohawk, seeking to have the base ROE for transmission service of 11.5%, which includes a NYISO participation incentive adder, lowered to 9.49%. Similarly, on November 2, 2012 the Municipal Electric Utilities Association ("MEUA") filed a complaint to lower Niagara Mohawk's ROE to 9.25% including the NYISO participation adder. The MEUA also challenges certain aspects of Niagara Mohawk's transmission formula rate. On February 6, 2014, the NYAPP filed a further complaint against Niagara Mohawk seeking an order effective February 6, 2014 to reduce the ROE used in calculating rates for transmission service under the NYISO Open Access Transmission Tariff ("OATT") to 9.36%, inclusive of the 50 basis point adder for participation in the NYISO, with a corresponding overall weighted cost of capital of 6.60%. At this time, Niagara Mohawk cannot predict the outcome of the complaint. Any change in the ROE would not have an impact on net income because the retail rate plan fully reconciles any increase or decrease in wholesale transmission revenue under the FERC Transmission Service Charge rate through a Transmission Revenue Adjustment Clause mechanism.

*Wholesale Transmission Service Charge*

On December 6, 2013, Niagara Mohawk submitted a filing for FERC approval of revisions to its Wholesale Transmission Service Charge ("TSC Rate") under the NYSIO OATT to recover its RSS costs under two agreements with NRG to support the reliability of Niagara Mohawk's transmission system while transmission reinforcements are constructed. On February 4, 2014 the FERC allowed the RSS charges to become effective in TSC Rates as of July 1, 2013, subject to refund and further consideration of the matter by the FERC.

*Management Audit*

In February 2011, the NYPSC selected Overland Consulting Inc., ("Overland") to perform a management audit of NGUSA's affiliate cost allocations, policies and procedures. Niagara Mohawk and the New York Gas Companies disputed certain of Overland's final audit conclusions and the NYPSC ordered that further proceedings be conducted to address what, if any, rate-making adjustments were necessary. On September 5, 2014, the NYPSC approved a settlement that resolves all outstanding issues relating to the audit. The order provides for no rate adjustments for Niagara Mohawk and $24.7 million to be returned for the benefit of customers for the New York Gas Companies. This amount is recorded as a regulatory liability in the accompanying consolidated balance sheets.

*Gas Management Audit*

In February 2013, the NYPSC initiated a comprehensive management and operational audit of the NGUSA's New York gas businesses, including Niagara Mohawk, pursuant to the Public Service Law requirement that major electric and gas utilities undergo an audit every five years. On June 13, 2013, the NYPSC selected NorthStar Consulting Group to conduct the audit, which commenced in July 2013. The final audit report was issued on October 2, 2014 and contained recommendations primarily relating to gas operations, organizational structure and governance. The next phase of the audit presents an opportunity for NGUSA to develop implementation plans that address the recommendations.

*Operations Audit*

In August 2013, the NYPSC initiated an operational audit to review the accuracy of the customer service, electric reliability, and gas safety data reported by the investor owned utilities operating in New York, including Niagara Mohawk and the New York Gas Companies. On December 19, 2013, the NYPSC selected Overland to conduct the audit, which commenced in February 2014. At the time of the issuance of these consolidated financial statements, the Company has not received the final audit findings and cannot predict the outcome of this audit.

*Operations Staffing Audit*

In January 2014, the NYPSC initiated an operational audit to review internal staffing levels and use of contractors for the core utility functions of the investor owned utilities operating in New York, including Niagara Mohawk. On June 26, 2014, the NYPSC selected The Liberty Consulting Group to conduct the audit. At the time of the issuance of these consolidated financial statements, Niagara Mohawk cannot predict the outcome of this operational audit.

*Recovery of Deferral Costs Relating to Emergency Order*

On January 28, 2014, Niagara Mohawk filed a petition requesting a waiver of Rule 46.3.2 of its tariff. Rule 46.3.2 describes the manner in which Niagara Mohawk calculates its supply-related Mass Market Adjustment ("MMA"). Niagara Mohawk proposed the waiver of the rule to mitigate adverse financial impacts anticipated from a significant and unusual increase in electric commodity prices for its mass market customers.

On that same date, the NYPSC issued, on an emergency basis pursuant to the State Administrative Procedure Act §202(6), an Emergency Order granting Niagara Mohawk's waiver request (the "Emergency Order"). In the Emergency Order, the NYPSC waived the requirements of Rule 46.3.2 and approved deferral treatment of the costs and associated carrying charges related to the one-time credit provided via the waiver. However, the NYPSC denied, pending further review and consideration of public comments, Niagara Mohawk's request to recover such deferral over a six-month period beginning May 2014.

The NYPSC issued another order on April 25, 2014 permanently approving the Emergency Order and authorizing Niagara Mohawk to collect $33.3 million, plus carrying charges at the customer deposit rate, over a six-month period commencing with the June 2014 billing period. The deferral recovery will be performed in a manner consistent with the method that was used to provide the benefit to the mass market customers, through an adjustment to the MMA as calculated by NYISO load zone.

*Petition for Authorization to Defer an Actuarial Experience Pension Settlement Loss for Fiscal Year 2014*

On February 28, 2014, Niagara Mohawk filed a petition seeking authorization to defer a pension settlement loss incurred during fiscal year 2014. The petition reflected actual loss amounts through December 31, 2013. On August 13, 2014, Niagara Mohawk filed a supplemental petition with actual results through March 31, 2014. In total, Niagara Mohawk seeks authorization to defer $14.1 million related to a pension settlement loss that occurred in fiscal year 2014.

**The New York Gas Companies**

*General Rate Case*

KeySpan Gas East has been subject to a rate plan with a primary term of five years (2008-2012), which remains in effect until modified by the NYPSC. Under this rate plan, base delivery rates include an allowed ROE of 9.8%.

On June 13, 2013, the NYPSC approved a settlement covering the Brooklyn Union's 2013 and 2014 rate years. Brooklyn Union's revenue requirements for both years have been modified as follows: (i) there is no change in base delivery rates, other than those previously approved by the NYPSC in the rate plan, (ii) the allowed ROE has decreased from 9.8% to 9.4%, and (iii) the common equity ratio in the capital structure has increased from 45% to 48%.

*Capital Investment*

On June 13, 2014, KeySpan Gas East filed a petition with the NYPSC to implement a three-year capital investment program that would allow KeySpan Gas East to invest more than $700.0 million in gas infrastructure projects designed to enhance the safety and reliability of its gas systems and promote gas growth, while maintaining base delivery rates. The petition seeks (i) a new deferral mechanism that would permit KeySpan Gas East to defer for future recovery in rates the pre-tax revenue requirement associated with its capital spending program to the extent the amount of such investments exceeds the level of book depreciation expense reflected in KeySpan Gas East's rates; and (ii) the elimination of its existing city/state construction and non-growth related capital deferral mechanisms. KeySpan Gas East has requested that the NYPSC grant this relief by the end of September 2014, however, the NYPSC has not yet acted on the petition.

**Massachusetts Electric and Nantucket (the "Massachusetts Electric Companies")**

*2009 Capital Investments Audit*

Rates for services rendered by the Massachusetts Electric Companies are subject to approval by the DPU. The DPU approved an RDM arising from the 2009 distribution rate case filed by the Massachusetts Electric Companies. As part of their RDM provision, the Massachusetts Electric Companies file a report by July 1st of each year on their capital investment for the prior calendar year. In connection with the Massachusetts Electric Companies' first capital expenditure ("CapEx") filing made in July 2010, the DPU opened a proceeding in March 2011, as requested by the Massachusetts Attorney General's Office ("Attorney General"), for an independent audit of the Massachusetts Electric Companies' 2009 capital investments which, in part, formed the basis for the Massachusetts Electric Companies' RDM rate adjustment. On July 31, 2014, the DPU issued an order approving the sole bidder's bid to perform the CapEx audit. As required by the Order, the Massachusetts Electric Companies have conferred with the Attorney General and the auditor, and on August 21, 2014 the Massachusetts Electric Companies submitted a revised work plan and final contract for the audit to the DPU. After a comment period the DPU will issue a final order on the revised work plan and contract, which will determine the next steps for the audit. The Massachusetts Electric Companies cannot currently predict the outcome of this proceeding.

*Cost Recovery*

In addition to the rates and tariffs put into effect following its most recent rate case, Massachusetts Electric continues to be authorized to recover costs associated with the procurement of electricity for its customers, all transmission costs, and costs charged by Massachusetts Electric's affiliate NEP, for stranded costs associated with NEP's former electric generation investments.

*DPU Audit Settlement Agreement*

In the general rate case involving the Company's Massachusetts gas distribution subsidiaries, the DPU opened an investigation to address the allocation and assignment of costs to the gas affiliates by the NGUSA service companies. The audit was later expanded to include the Massachusetts Electric Companies. The Massachusetts Electric Companies, the Massachusetts Gas Companies and the Attorney General's Office executed a Settlement Agreement that the DPU approved on July 25, 2014. As a result of the approval of the Settlement, there is no need for an audit, and both the Massachusetts Gas and Massachusetts Electric Companies will implement reporting and review practices similar to those in place for their New York affiliates, and NGUSA contributed $1 million to the Massachusetts Association for Community Action that will be used for the benefit of the Massachusetts Electric Companies' electric customers and customers of its Massachusetts gas distribution affiliates who are eligible for fuel assistance.

*Storm Management Audit*

In January 2011, the DPU opened an investigation into the Massachusetts Electric Companies' preparation and response to a December 2010 winter storm. The DPU has the authority to issue fines not to exceed approximately $0.3 million for each violation for each day that the violation persists. On September 22, 2011, the DPU approved a settlement between the Massachusetts Electric Companies and the Attorney General that included a $1.2 million refund to customers. The DPU also investigated the Massachusetts Electric Companies' response to Tropical Storm Irene and the October 2011 winter storm in a consolidated proceeding. On December 11, 2012, the DPU issued an order in which it assessed the Massachusetts Electric Companies a penalty of $18.7 million associated with the Massachusetts Electric Companies' performance in responding to these two weather events, consisting of $8.1 million for Tropical Storm Irene and $10.6 million for the October 2011 winter storm. The Massachusetts Electric Companies appealed this ruling and on September 4, 2014 the Court affirmed all but two violations, reducing the penalty by $0.9 million. The Massachusetts Electric Companies had recorded the original penalty and credited customers during March 2013. In addition, in the December 11, 2012 order, the DPU ordered a management audit of the Massachusetts Electric Companies' emergency planning, outage management, and restoration. The auditors have completed their audit, and submitted their Final Report to the DPU on July 9, 2014. No parties submitted comments on the Final Report. The Massachusetts Electric Companies cannot predict the outcome of the management audit.

*2010 Service Quality Report*

On December 30, 2013, the DPU issued an order on Massachusetts Electric's calendar year 2010 Service Quality report, ordering that Massachusetts Electric refund to customers a net penalty of $6.7 million. On January 21, 2014, Massachusetts Electric filed a Motion for Clarification/Reconsideration regarding a portion of the penalty amount related to Circuit Average Interruption Frequency Index which totaled $2.7 million. In addition, Massachusetts Electric filed a proposal to credit customers the $6.7 million penalty along with a proposed tariff that would allow for recovery of the $2.7 million if the DPU rules in favor of Massachusetts Electric regarding the Motion for Clarification/Reconsideration. On May 21, 2014, the DPU denied Massachusetts Electric's motion.

**Boston Gas and Colonial Gas (the "Massachusetts Gas Companies")**

*General Rate Case*

In November 2010, the DPU issued an order in the Massachusetts Gas Companies' 2010 rate case approving a revenue increase of $58.0 million based upon a 9.75% rate of return on equity and a 50% equity ratio. The Massachusetts Gas Companies filed two motions in response. These motions resulted in a final revenue increase of $65.3 million reflected in rates effective February 1, 2013.

*PBOP Carrying Charges*

On June 1, 2011, in conjunction with the DPU's annual investigation of Boston Gas' calendar year 2009 pension and PBOP rate reconciliation mechanism, the Massachusetts Attorney General ("AG") argued that Boston Gas be obligated to provide carrying charges to the benefit of customers on its PBOP liability balances related to its 2003 to 2006 rate reconciliation filings. In August 2010, the DPU ordered Boston Gas to provide carrying charges on its PBOP liability balances on its 2007 and 2008 rate reconciliation filings, but the order was silent about providing carrying charges prior to those years. On August 29, 2014, the DPU agreed with the AG and ordered Boston Gas to provide carrying charges on its 2003 to 2006 PBOP liability balances in its next annual pension and PBOP reconciliation filing. Boston Gas is evaluating the impact of this decision.

**New England Power**

*Stranded Cost Recovery*

Under settlement agreements approved by state commissions and the FERC, NEP is permitted to recover stranded costs (those costs associated with its former generating investments (nuclear and non-nuclear) and related contractual commitments that were not recovered through the sale of those investments). NEP earns an ROE of approximately 11% on stranded cost recovery. NEP will recover remaining non-nuclear stranded costs through 2020. NEP will recover remaining non-nuclear stranded costs through 2020. See "Decommissioning Nuclear Units" in Note 13 "Commitments and Contingencies," for a discussion of ongoing costs associated with decommissioned nuclear units.

*Transmission Return on Equity*

NEP's transmission rates during the reporting period reflect a base ROE of 11.14% applicable to all transmission facilities, plus an additional 0.5% Regional Transmission Organizations ("RTO") participation adder applicable to transmission facilities included under the Regional Network Service ("RNS") rate. Approximately 70% of the NEP's transmission facilities are included under RNS rates. NEP earns an additional 1.0% ROE incentive adder on RNS-related transmission facilities approved under the RTO's Regional System Plan and placed in service on or before December 31, 2008. It also earns 1.25% ROE on its portion of New England East-West Solution ("NEEWS") as described below. On October 16, 2014, the FERC issued an order as the result of a ROE complaint case (as described in "FERC ROE Complaints" in Note 13 "Commitments and Contingencies,") that set NEP's base ROE, effective from the date of the order, at 10.57% with total or maximum ROE including the aforementioned incentives not to exceed 11.74%.

*New England East-West Solution*

In September 2008, NEP, its affiliate Narragansett, and Northeast Utilities jointly filed an application with the FERC to recover financial incentives for the NEEWS, pursuant to the FERC's Transmission Pricing Policy Order No. 679. NEEWS consists of a series of inter-related transmission upgrades identified in the New England Regional System Plan and is being undertaken to address a number of reliability problems in Connecticut, Massachusetts, and Rhode Island. Effective November 2008, the FERC granted (1) an incentive ROE of 12.89% (125 basis points above the approved base ROE of 11.64% including the RTO participation adder), (2) 100% construction work in progress in rate base and (3) recovery of plant abandoned for reasons beyond the companies' control. In its June 19, 2014 order on the first NETO ROE complaint, the FERC ordered that all ROE incentives, such as the NEEWS incentive ROE, be capped at 11.74% subject to further limited proceedings to determine growth rates that would be used in calculating the final cap. It is currently unclear how the FERC's order will affect the ROE for NEEWS.

**Narragansett**

*General Rate Case*

On December 20, 2012, the RIPUC approved a settlement agreement among the Rhode Island Division of Public Utilities and Carriers, the Department of the Navy, and Narragansett, which provided for an increase in electric base distribution revenue of $21.5 million and an increase in gas base distribution revenue of $11.3 million based on a 9.5% allowed ROE and a common equity ratio of approximately 49.1%, effective February 1, 2013. The settlement also included reinstatement of base rate recovery of storm fund contributions and implementation of a Pension Adjustment Mechanism ("PAM") for pension and PBOP expenses for the electric business identical to the mechanism in place for the gas business.

## 5. PROPERTY, PLANT AND EQUIPMENT

The following table summarizes property, plant, and equipment at cost along with accumulated depreciation and amortization:

| | March 31, | |
|---|---|---|
| | **2014** | 2013 |
| | *(in millions of dollars)* | |
| Plant and machinery | **$ 27,034** | $ 25,181 |
| Property held for future use | **16** | 24 |
| Land and buildings | **2,075** | 2,027 |
| Assets in construction | **1,410** | 1,380 |
| Software and other intangibles | **637** | 530 |
| Total property, plant and equipment | **31,172** | 29,142 |
| Accumulated depreciation and amortization | **(7,297)** | (6,643) |
| Property, plant and equipment, net | **$ 23,875** | $ 22,499 |

## 6. DERIVATIVE CONTRACTS AND HEDGING

The Company utilizes derivative instruments to manage commodity price, interest and currency rate risk associated with its natural gas and electricity purchases and its Euro Medium Term Note borrowings. The Company's commodity risk management strategy is to reduce fluctuations in firm gas and electricity sales prices to its customers. The Company's interest rate risk management strategy is to minimize its cost of capital. The Company's currency rate risk management policy is to hedge the risk associated with its foreign currency borrowings by utilizing instruments to convert principle and interest payments into U.S. dollars.

The Company's financial exposures are monitored and managed as an integral part of the Company's overall financial risk management policy. The Company engages in risk management activities, only in commodities and financial markets where it has an exposure to, and only in terms and volumes consistent with its core business.

**Volumes**

Volumes of outstanding commodity derivative contracts measured in dekatherms ("dths") and megawatt hours ("Mwhs") are as follows:

| | Electric | | Gas | |
|---|---|---|---|---|
| | March 31, | | March 31, | |
| | **2014** | 2013 | **2014** | 2013 |
| | *(in millions)* | | *(in millions)* | |
| Gas purchase contracts (dths) | **-** | - | **87** | 59 |
| Gas swap contracts (dths) | **-** | - | **50** | 66 |
| Gas option contracts (dths) | **-** | - | **23** | 4 |
| Gas future contracts (dths) | **-** | - | **20** | 17 |
| Electric swap contracts (Mwhs) | **7** | 6 | **-** | - |
| Total: | **7** | 6 | **180** | 146 |

**Amounts Recognized in the Accompanying Consolidated Balance Sheets**:

| | Asset Derivatives | | | Liability Derivatives | |
|---|---|---|---|---|---|
| | March 31, | | | March 31, | |
| | **2014** | 2013 | | **2014** | 2013 |
| | *(in millions of dollars)* | | | *(in millions of dollars)* | |
| Current assets: | | | Current liabilities: | | |
| Rate recoverable contracts: | | | Rate recoverable contracts: | | |
| Gas swap contracts | **$ 12** | $ 15 | Gas swap contracts | **$ 4** | $ 6 |
| Gas future contracts | **3** | 1 | Gas future contracts | **1** | 2 |
| Gas option contracts | **2** | 1 | Gas option contracts | **1** | - |
| Gas purchase contracts | **11** | 15 | Gas purchase contracts | **36** | 3 |
| Electric swap contracts | **36** | 18 | Electric swap contracts | **1** | - |
| Electric option contracts | **1** | - | Electric option contracts | **-** | - |
| Hedge contracts: | | | Hedge contracts: | | |
| CCIRS | **5** | 11 | CCIRS | **-** | - |
| | **70** | 61 | | **43** | 11 |
| Deferred charges and other assets: | | | Deferred credits and other liabilities: | | |
| Rate recoverable contracts: | | | Rate recoverable contracts: | | |
| Gas swap contracts | **-** | 1 | Gas swap contracts | **-** | - |
| Gas future contracts | **-** | 2 | Gas future contracts | **-** | - |
| Gas purchase contracts | **18** | 4 | Gas purchase contracts | **5** | 7 |
| Electric swap contracts | **8** | 6 | Electric swap contracts | **9** | 1 |
| Hedge contracts: | | | Hedge contracts: | | |
| CCIRS | **-** | 1 | CCIRS | **-** | 56 |
| | **26** | 14 | | **14** | 64 |
| Total | **$ 96** | $ 75 | Total | **$ 57** | $ 75 |

The changes in fair value of the Company's rate recoverable contracts are offset by changes in regulatory assets and liabilities. As a result, the changes in fair value of those contracts had no impact in the accompanying consolidated statements of income. The changes in fair value of the Company's contracts not subject to rate recovery are recorded within purchased gas in the accompanying consolidated statements of income.

**Credit and Collateral**

The Company is exposed to credit risk related to transactions entered into for commodity price, interest and currency risk management. Credit risk represents the risk of loss due to counterparty non-performance. Credit risk is managed by assessing each counterparty's credit profile and negotiating appropriate levels of collateral and credit support.

*Commodity Transactions*

The Company enters into commodity transactions on the New York Mercantile Exchange ("NYMEX"). The NYMEX clearinghouses act as the counterparty to each trade. Transactions on the NYMEX must adhere to comprehensive collateral and margining requirements. As a result, transactions on NYMEX are significantly collateralized and have limited counterparty credit risk.

The credit policy for commodity transactions is managed and monitored by the Executive Energy Risk Management Committee ("EERC"), which is responsible for approving risk management policies and objectives for risk assessment, control and valuation, and the monitoring and reporting of risk exposures. The Energy Procurement Risk Management Committee ("EPRMC") is responsible for approving transaction strategies, annual supply plans, counterparty credit approval, as well as all valuation and control procedures. The EERC is chaired by the Global Tax and Treasury Director and reports to the Finance Committee. The EPRMC is chaired by the Vice President of U.S. Treasury and reports to the EERC.

The EPRMC monitors counterparty credit exposure and appropriate measures are taken to bring such exposures below the limits, including, without limitation, netting agreements, and limitations on the type and tenor of trades. The Company enters into enabling agreements that allow for payment netting with its counterparties, which reduce its exposure to counterparty risk by providing for the offset of amounts payable to the counterparty against amounts receivable from the counterparty. In instances where a counterparty's credit quality has declined, or credit exposure exceeds certain levels, the Company may limit its credit exposure by restricting new transactions with the counterparty, requiring additional collateral or credit support and negotiating the early termination of certain agreements. Similarly, the Company may be required to post collateral to its counterparties.

The Company's credit exposure for all commodity derivative instruments, normal purchase normal sale contracts, and applicable payables and receivables, net of collateral and instruments that are subject to master netting agreements was $29 million and $42 million as of March 31, 2014 and 2013, respectively.

The aggregate fair value of the Company's commodity derivative instruments with credit-risk-related contingent features that is in a liability position at March 31, 2014 and 2013 was $16.9 million and $5.0 million, respectively. The Company had no collateral posted for these instruments at March 31, 2014 or 2013. If the Company's credit rating were to be downgraded by one or two levels, it would not be required to post any additional collateral. If the Company's credit rating were to be downgraded by three levels, it would be required to post $18.0 million additional collateral to its counterparties.

*Financing Transactions*

The credit policy for financing transactions is managed by a central Treasury department under policies approved by the Finance Committee. In accordance with these treasury policies, counterparty credit exposure utilizations are monitored daily against the counterparty credit limits. Counterparty credit ratings and market conditions are reviewed continually with limits being revised and utilization adjusted, if appropriate. Management does not expect any significant losses from non-performance by these counterparties.

In relation to the Company's cash flow hedge contracts, if the Company's credit rating were to be downgraded by one, two, or three levels, it would not be required to post any additional collateral.

## Offsetting Information for Derivatives Subject to Master Netting Arrangements

**March 31, 2014**
**Gross Amounts Not Offset in the Balance Sheets**
*(in millions of dollars)*

| **ASSETS:** Description | Gross amounts of recognized assets | Gross amounts offset in the Balance Sheets | Net amounts of assets presented in the Balance Sheets | Financial instruments | Cash collateral received | Net amount |
|---|---|---|---|---|---|---|
| | *A* | *B* | *C=A+B* | *Da* | *Db* | *E=C-D* |
| **Derivatives** | | | | | | |
| Gas swap contracts | $ 12 | $ - | $ 12 | $ - | $ - | $ 12 |
| Gas future contracts | 3 | - | 3 | - | 3 | - |
| Gas option contracts | 2 | - | 2 | - | - | 2 |
| Gas purchase contracts | 29 | - | 29 | - | - | 29 |
| Electric swap contracts | 44 | - | 44 | - | 3 | 41 |
| Electric option contracts | 1 | - | 1 | - | - | 1 |
| CCIRS | 5 | - | 5 | - | - | 5 |
| Total | $ 96 | $ - | $ 96 | $ - | $ 6 | $ 90 |

| **LIABILITIES:** Description | Gross amounts of liabilities | Gross amounts offset in the Balance Sheets | Net amounts of presented in the Balance Sheets | Financial instruments | Cash collateral paid | Net amount |
|---|---|---|---|---|---|---|
| | *A* | *B* | *C=A+B* | *Da* | *Db* | *E=C-D* |
| **Derivatives** | | | | | | |
| Gas swap contracts | $ 4 | $ - | $ 4 | $ - | $ - | $ 4 |
| Gas future contracts | 1 | - | 1 | - | 1 | - |
| Gas option contracts | 1 | - | 1 | - | - | 1 |
| Gas purchase contracts | 41 | - | 41 | - | - | 41 |
| Electric swap contracts | 10 | - | 10 | - | - | 10 |
| Total | $ 57 | $ - | $ 57 | $ - | $ 1 | $ 56 |

**March 31, 2013**

**Gross Amounts Not Offset in the Balance Sheets**

*(in millions of dollars)*

| **ASSETS:** Description | Gross amounts of recognized assets | Gross amounts offset in the Balance Sheets | Net amounts of assets presented in the Balance Sheets | Financial instruments | Cash collateral received | Net t |
|---|---|---|---|---|---|---|
| | *A* | *B* | *C=A+B* | *Da* | *Db* | *E=C-D* |
| **Derivatives** | | | | | | |
| Gas swap contracts | $ 16 | $ - | $ 16 | $ - | $ - | $ 16 |
| Gas future contracts | 3 | - | 3 | - | 3 | - |
| Gas option contracts | 1 | - | 1 | - | - | 1 |
| Gas purchase contracts | 19 | - | 19 | - | - | 19 |
| Electric swap contracts | 24 | - | 24 | - | - | 24 |
| CCIRS | 12 | - | 12 | - | - | 12 |
| Total | $ 75 | $ - | $ 75 | $ - | $ 3 | $ 72 |

| **LIABILITIES:** Description | Gross amounts of liabilities | Gross amounts offset in the Balance Sheets | liabilities presented in the Balance Sheets | Financial instruments | Cash collateral paid | Net t |
|---|---|---|---|---|---|---|
| | *A* | *B* | *C=A+B* | *Da* | *Db* | *E=C-D* |
| **Derivatives** | | | | | | |
| Gas swap contracts | $ 6 | $ - | $ 6 | $ - | $ - | $ 6 |
| Gas future contracts | 2 | - | 2 | - | 1 | 1 |
| Gas purchase contracts | 10 | - | 10 | - | - | 10 |
| Electric swap contracts | 1 | - | 1 | - | - | 1 |
| CCIRS | 56 | - | 56 | - | 6 | 50 |
| Total | $ 75 | $ - | $ 75 | $ - | $ 7 | $ 68 |

## 7. FAIR VALUE MEASUREMENTS

The following tables present assets and liabilities measured and recorded at fair value in the accompanying consolidated balance sheets on a recurring basis and their level within the fair value hierarchy as of March 31, 2014 and 2013:

| | March 31, 2014 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | (in millions of dollars) | | | |
| **Assets:** | | | | |
| Derivative contracts | | | | |
| Gas swaps contracts | $ - | $ 12 | $ - | $ 12 |
| Gas futures contracts | 3 | - | - | 3 |
| Gas options contracts | - | - | 2 | 2 |
| Gas purchase contracts | - | 1 | 28 | 29 |
| Electric swaps contracts | - | 44 | - | 44 |
| Electric options contracts | - | - | 1 | 1 |
| CCIRS | - | 5 | - | 5 |
| Available-for-sale securities | 113 | 124 | - | 237 |
| Total | 116 | 186 | 31 | 333 |
| **Liabilities:** | | | | |
| Derivative contracts | | | | |
| Gas swaps contracts | - | 4 | - | 4 |
| Gas futures contracts | 1 | - | - | 1 |
| Gas options contracts | - | - | 1 | 1 |
| Gas purchase contracts | - | 5 | 36 | 41 |
| Electric swaps contracts | - | 10 | - | 10 |
| Total | 1 | 19 | 37 | 57 |
| **Net assets** | $ 115 | $ 167 | $ (6) | $ 276 |

| | March 31, 2013 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | (in millions of dollars) | | | |
| **Assets:** | | | | |
| Derivative contracts | | | | |
| Gas swaps contracts | $ - | $ 16 | $ - | $ 16 |
| Gas futures contracts | 3 | - | - | 3 |
| Gas options contracts | - | - | 1 | 1 |
| Gas purchase contracts | - | 1 | 18 | 19 |
| Electric swaps contracts | - | 24 | - | 24 |
| CCIRS | - | 12 | - | 12 |
| Available-for-sale securities | 134 | 115 | - | 249 |
| Total | 137 | 168 | 19 | 324 |
| **Liabilities:** | | | | |
| Derivative contracts | | | | |
| Gas swaps contracts | - | 6 | - | 6 |
| Gas futures contracts | 2 | - | - | 2 |
| Gas purchase contracts | - | 2 | 8 | 10 |
| Electric swaps contracts | - | 1 | - | 1 |
| CCIRS | - | 56 | - | 56 |
| Total | 2 | 65 | 8 | 75 |
| **Net assets** | $ 135 | $ 103 | $ 11 | $ 249 |

**Derivative Contracts**: The Company's Level 1 fair value derivative instruments primarily consist of quoted prices (unadjusted) in active markets for identical assets or liabilities that a company has the ability to access as of the reporting date. Derivative assets and liabilities utilizing Level 1 inputs include active exchange-based derivatives (e.g. natural gas futures traded on NYMEX).

The Company's Level 2 fair value derivative instruments primarily consist of over-the-counter ("OTC") interest and currency swap transactions, and gas swap contracts with pricing inputs obtained from the New York Mercantile Exchange and Intercontinental Exchange ("ICE"), except in cases where the ICE publishes seasonal averages or where there were no transactions within the last seven days. The Company may utilize discounting based on quoted interest rate curves, including consideration of non-performance risk, and may include a liquidity reserve calculated based on bid/ask spread for the Company's Level 2 derivative instruments. Substantially all of these price curves are observable in the marketplace throughout at least 95% of the remaining contractual quantity, or they could be constructed from market observable curves with correlation coefficients of 95% or higher.

The Company's Level 3 fair value derivative instruments consist of OTC gas option contracts and gas purchase contracts, which are valued based on internally-developed models. Industry-standard valuation techniques, such as the Black-Scholes pricing model, Monte Carlo simulation, and Financial Engineering Associates libraries are used for valuing such instruments. A derivative is designated Level 3 when it is valued based on a forward curve that is internally developed, extrapolated or derived from market observable curves with correlation coefficients less than 95%, where optionality is present, or if non-economic assumptions are made. The internally developed forward curves have a high level of correlation with Platts Mark-to-Market curves and are reviewed by the middle office. The Company considers non-performance risk and liquidity risk in the valuation of derivative contracts categorized in Level 2 and Level 3.

**Available-for-Sale Securities:** Available-for-sale securities are included in other non-current assets in the accompanying consolidated balance sheets and primarily include equity and debt investments based on quoted market prices (Level 1) and municipal and corporate bonds based on quoted prices of similar traded assets in open markets (Level 2).

**Changes in Level 3 Derivatives**

| | Years Ended March 31, | |
|---|---|---|
| | **2014** | **2013** |
| | *(in millions of dollars)* | |
| Balance as of the beginning of the year | **$ 11** | $ 25 |
| Transfers out of Level 3 | **1** | (4) |
| Total gains or losses included in regulatory assets and liabilities | **(23)** | (17) |
| Settlements | **5** | 7 |
| Balance as of the end of the year | **$ (6)** | $ 11 |
| The amount of total gains or losses for the year included in net income attributed to the change in unrealized gains or losses related to non-regulatory assets and liabilities at year-end | **$ -** | $ - |

A transfer into Level 3 represents existing assets or liabilities that were previously categorized at a higher level for which the inputs became unobservable during the year. A transfer out of Level 3 represents assets and liabilities that were previously classified as Level 3 for which the inputs became observable based on the criteria discussed previously for classification in Level 2. These transfers, which are recognized at the end of each period, result from changes in the observability of forward curves from the beginning to the end of each reporting period. There were no transfers between Level 1 and Level 2, and no transfers into Level 3, during the years ended March 31, 2014 or 2013.

For valuations that include both observable and unobservable inputs, if the unobservable input is determined to be significant to the overall inputs, the entire valuation is categorized in Level 3. This includes derivatives valued using indicative price quotations whose contract tenure extends into unobservable periods. In instances where observable data is unavailable, consideration is given to the assumptions that market participants would use in valuing the asset or liability. This includes assumptions about market risks such as liquidity, volatility and contract duration. Such instruments are categorized in Level 3 as the model inputs generally are not observable. The forward curves used for financial reporting are developed and verified by the middle office. The Company considers non-performance risk and liquidity risk in the valuation of derivative contracts categorized in Level 2 and Level 3.

The following tables provide information about the Company's Level 3 valuations:

**Quantitative Information About Level 3 Fair Value Measurements**

| Commodity | Level 3 Position | Fair Value as of March 31, 2014 | | | Valuation Technique(s) | Significant Unobservable Input | Range |
|---|---|---|---|---|---|---|---|
| | | Assets | (Liabilities) | Total | | | |
| | | (in millions of dollars) | | | | | |
| Gas | Purchase Contracts | $ 28 | $ (36) | $ (8) | Discounted Cash Flow | Forward Curve and LNG Forward Curve | $2.434-$98.98/Dth |
| Gas | Options Contracts | 2 | (1) | 1 | Discounted Cash Flow | Forward Curve | $(1.070)-$0.720/Dth |
| Electric | Options Contracts | 1 | - | 1 | Discounted Cash Flow | Implied Volatility | 29%-65% |
| | **Total** | $ 31 | $ (37) | $ (6) | | | |

**Quantitative Information About Level 3 Fair Value Measurements**

| Commodity | Level 3 Position | Fair Value as of March 31, 2013 | | | Valuation Technique(s) | Significant Unobservable Input | Range |
|---|---|---|---|---|---|---|---|
| | | Assets | (Liabilities) | Total | | | |
| | | (in millions of dollars) | | | | | |
| Gas | Purchase Contracts | $ 18 | $ (8) | $ 10 | Discounted Cash Flow | Forward Curve | $3.816-$93.21/Dth |
| Gas | Options Contracts | 1 | - | 1 | Discounted Cash Flow | Forward Curve | $0.274-$0.352/Dth |
| | **Total** | $ 19 | $ (8) | $ 11 | | | |

The significant unobservable inputs listed above would have a direct impact on the fair values of the Level 3 instruments if they were adjusted. The significant unobservable inputs used in the fair value measurement of the Company's gas purchase and gas and electric option derivatives are forward commodity prices, both gas and electric, implied volatility and valuation assumptions pertaining to the peaking gas deals based on the forward gas curves. A relative change in commodity price at various locations underlying the open positions can result in significantly different fair value estimates.

**Other Fair Value Measurements**

The Company's consolidated balance sheets reflect long-term debt at amortized cost. The fair value of the Company's long-term debt was based on quoted market prices when available, or estimated using quoted market prices for similar debt. The fair value of this debt at March 31, 2014 and 2013 was $9.9 billion and $10.4 billion, respectively.

All other financial instruments in the accompanying consolidated balance sheets such as accounts receivable, accounts payable, and the intercompany money pool are stated at cost, which approximates fair value.

## 8. EMPLOYEE BENEFITS

The Company sponsors numerous non-contributory defined benefit pension plans (the "Pension Plans") and several PBOP Plans. In general, the Company calculates benefits under these plans based on age, years of service and pay using March 31 as a measurement date. In addition, the Company also sponsors defined contribution plans for eligible employees.

*Pension Plans*

The Pension Plans are comprised of both qualified and non-qualified plans. The qualified pension plans provide union employees, as well as all non-union employees hired before January 1, 2011, with a retirement benefit. Supplemental, non-qualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives. The Company funds the qualified plans by contributing at least the minimum amount required under Internal Revenue Service ("IRS") regulations. The Company expects to contribute approximately $196 million to the Pension Plans during the year ended March 31, 2015.

*PBOP Plans*

The PBOP Plans provide health care and life insurance coverage to eligible retired employees. Eligibility is based on age and length of service requirements and, in most cases, retirees must contribute to the cost of their coverage. The Company funds these plans based on the requirements of the various regulatory jurisdictions in which it operates. The Company expects to contribute approximately $181 million to the PBOP Plans during the year ended March 31, 2015.

*Defined Contribution Plans*

The Company also has several defined contribution pension plans (primarily 401(k) employee savings fund plans) that cover substantially all employees. In addition, employees may receive certain employer contributions, including matching contributions and a 15% discount on the purchase of National Grid plc common stock. Employer matching contributions of approximately $38 million and $30 million, respectively, were expensed in the years ended March 31, 2014 and 2013.

**Components of Net Periodic Benefit Costs**

| | Pension Plans | | PBOP Plans | |
|---|---|---|---|---|
| | **Years Ended March 31,** | | **Years Ended March 31,** | |
| | **2014** | 2013 | **2014** | 2013 |
| | *(in millions of dollars)* | | | |
| Service cost, benefits earned during the year | **$ 134** | $ 133 | **$ 73** | $ 68 |
| Interest cost | **355** | 361 | **203** | 207 |
| Expected return on plan assets | **(443)** | (414) | **(170)** | (145) |
| Net amortization and deferral | **261** | 275 | **91** | 111 |
| Settlements/curtailments | **16** | 7 | **(140)** | (2) |
| Total cost | **$ 323** | $ 362 | **$ 57** | $ 239 |

All of the Company's regulated subsidiaries have regulatory recovery of these costs and therefore have recorded related regulatory assets (liabilities) in the accompanying consolidated balance sheets. The Company records amounts for its unregulated subsidiaries within operations and maintenance expense in the accompanying consolidated statements of income.

**Amounts Recognized in AOCI and Regulatory Assets**

| | Pension Plans | | PBOP Plans | |
|---|---|---|---|---|
| | Years Ended March 31, | | Years Ended March 31, | |
| | **2014** | 2013 | **2014** | 2013 |
| | *(in millions of dollars)* | | | |
| Net actuarial loss | **$ (18)** | $ 150 | **$ (319)** | $ 227 |
| Prior service cost | **-** | 11 | **(31)** | - |
| Amortization of gain | **(267)** | (272) | **58** | (98) |
| Amortization of prior service cost | **(10)** | (9) | **(9)** | (11) |
| Total | **$ (295)** | $ (120) | **$ (301)** | $ 118 |
| Included in regulatory assets | **$ (181)** | $ 22 | **$ (62)** | $ 66 |
| Included in AOCI | **(114)** | (142) | **(239)** | 52 |
| Total | **$ (295)** | $ (120) | **$ (301)** | $ 118 |

**Amounts Recognized in AOCI and Regulatory Assets – not yet recognized as components of net actuarial loss**

| | Pension Plans | | PBOP Plans | | Expected Amortization |
|---|---|---|---|---|---|
| | Years Ended March 31, | | Years Ended March 31, | | Year Ended March 31, |
| | **2014** | 2013 | **2014** | 2013 | 2015 |
| | *(in millions of dollars)* | | | | |
| Cumulative loss | **$ 1,681** | $ 1,966 | **$ 644** | $ 905 | **$ 306** |
| Prior service cost | **46** | 56 | **(23)** | 17 | **13** |
| Total | **$ 1,727** | $ 2,022 | **$ 621** | $ 922 | **$ 319** |
| Included in regulatory assets | **$ 886** | $ 1,067 | **$ 397** | $ 459 | |
| Included in accumulated other comprehensive income | **841** | 955 | **224** | 463 | |
| Total | **$ 1,727** | $ 2,022 | **$ 621** | $ 922 | |

**Reconciliation of Funded Status to Amount Recognized**

| | Pension Plans | | PBOP Plans | |
|---|---|---|---|---|
| | March 31, | | March 31, | |
| | **2014** | 2013 | **2014** | 2013 |
| | *(in millions of dollars)* | | | |
| Change in benefit obligation: | | | | |
| Benefit obligation as of the beginning of the year | **$ (7,724)** | $ (7,340) | **$ (4,589)** | $ (4,213) |
| Service cost | **(134)** | (133) | **(73)** | (68) |
| Interest cost on projected benefit obligation | **(355)** | (361) | **(203)** | (207) |
| Plan amendments | **-** | (11) | **31** | - |
| Net actuarial loss | **(157)** | (379) | **(103)** | (283) |
| Benefits paid | **357** | 418 | **190** | 194 |
| Actual Medicare Part D subsidy received | **-** | - | **(26)** | (33) |
| Curtailments and settlements | **141** | 3 | **304** | - |
| Divestitures | **-** | 79 | **-** | 21 |
| Benefit obligation as of the end of the year | **(7,872)** | (7,724) | **(4,469)** | (4,589) |
| Change in plan assets: | | | | |
| Fair value of plan assets as of the beginning of the year | **6,654** | 6,159 | **2,302** | 1,907 |
| Actual return on plan assets | **591** | 623 | **287** | 189 |
| Company contributions | **279** | 352 | **303** | 409 |
| Benefits paid | **(357)** | (418) | **(190)** | (194) |
| Settlements | **(115)** | (3) | **-** | - |
| Divestitures | **-** | (59) | **-** | (9) |
| Fair value of plan assets as of the end of the year | **7,052** | 6,654 | **2,702** | 2,302 |
| Funded status | **$ (820)** | $ (1,070) | **$ (1,767)** | $ (2,287) |

The benefit obligation shown above is the projected benefit obligation ("PBO") for the Pension Plans and the accumulated benefit obligation ("ABO") for the PBOP Plans. The Company is required to reflect the funded status of its Pension Plans above in terms of the PBO, which is higher than the ABO, because the PBO includes the impact of expected future compensation increases on the pension obligation. The Pension Plans had ABO balances that exceeded the fair value of plans assets as of March 31, 2014 and 2013. The aggregate ABO balances for the Pension Plans were $7.4 billion and $7.2 billion as of March 31, 2014 and 2013, respectively.

**Amounts Recognized in the Accompanying Consolidated Balance Sheets**

| | Pension Plans | | PBOP Plans | |
|---|---|---|---|---|
| | March 31, | | March 31, | |
| | **2014** | 2013 | **2014** | 2013 |
| | *(in millions of dollars)* | | | |
| Non-current assets | **$ 290** | $ 297 | **$ 15** | $ - |
| Current liabilities | **(22)** | (23) | **(16)** | (11) |
| Non-current liabilities | **(1,088)** | (1,344) | **(1,766)** | (2,276) |
| Total | **$ (820)** | $ (1,070) | **$ (1,767)** | $ (2,287) |

**Expected Benefit Payments**

Based on current assumptions, the Company expects to make the following benefit payments subsequent to March 31, 2014:

| *(in millions of dollars)*<br>Years Ended March 31, | Pension Benefits | Postretirement Benefits |
|---|---|---|
| 2015 | $ 486 | $ 199 |
| 2016 | 491 | 206 |
| 2017 | 497 | 213 |
| 2018 | 499 | 220 |
| 2019 | 498 | 226 |
| Thereafter | 2,510 | 1,223 |
| Total | $ 4,981 | $ 2,287 |

**Assumptions Used for Employee Benefits Accounting**

| | **Pension Plans** | | **PBOP Plans** | |
|---|---|---|---|---|
| | **Years Ended March 31,** | | **Years Ended March 31,** | |
| | **2014** | 2013 | **2014** | 2013 |
| Benefit Obligations | | | | |
| Discount rate | **4.80%** | 4.70% | **4.80%** | 4.70% |
| Rate of compensation increase | **3.50%** | 3.50% | **3.50%** | n/a |
| Expected return on plan assets | **7.00%** | 6.75%-7.25% | **7.00% - 7.25%** | 7.25%-7.50% |
| Net Periodic Benefit Costs | | | | |
| Discount rate | **4.70%** | 5.10% | **4.70%** | 5.10% |
| Rate of compensation increase | **3.50%** | 3.50% | **n/a** | n/a |
| Expected return on plan assets | **6.75% - 7.25%** | 6.75%-7.25% | **7.25%-7.50%** | 7.25%-7.50% |

The Company selects its discount rate assumption based upon rates of return on highly rated corporate bond yields in the marketplace as of each measurement date. Specifically, the Company uses the Hewitt AA Above Median Curve along with the expected future cash flows from the Company retirement plans to determine the weighted average discount rate assumption.

The expected rate of return for various passive asset classes is based both on analysis of historical rates of return and forward looking analysis of risk premiums and yields. Current market conditions, such as inflation and interest rates, are evaluated in connection with the setting of the long-term assumptions. A small premium is added for active management of both equity and fixed income securities. The rates of return for each asset class are then weighted in accordance with the actual asset allocation, resulting in a long-term return on asset rate for each plan.

**Assumed Health Cost Trend Rate**

| | March 31, 2014 | March 31, 2013 |
|---|---|---|
| Health care cost trend rate assumed for next year | | |
| Pre 65 | **8.00%** | 8.00% |
| Post 65 | **7.00%** | 7.50% |
| Prescription | **7.00%** | 8.25% |
| Rate to which the cost trend is assumed to decline (ultimate) | **5.00%** | 5.00% |
| Year that rate reaches ultimate trend | | |
| Pre 65 | **2022** | 2019 |
| Post 65 | **2021** | 2018 |
| Prescription | **2021** | 2020 |

**Sensitivity to Changes in Assumed Health Care Cost Trend Rates**

| *(in millions of dollars)* | March 31, 2014 |
|---|---|
| 1% point increase | |
| Total of service cost plus interest cost | $ 51 |
| Postretirement benefit obligation | 642 |
| 1% point decrease | |
| Total of service cost plus interest cost | (41) |
| Postretirement benefit obligation | (542) |

**Plan Assets**

The Company manages the benefit plan investments to minimize the long-term cost of operating the plans, with a reasonable level of risk. Risk tolerance is determined as a result of a periodic asset/liability study which analyzes the plans' liabilities and funded status and results in the determination of the allocation of assets across equity and fixed income securities. Equity investments are broadly diversified across U.S. and non-U.S. stocks, as well as across growth, value, and small and large capitalization stocks. Likewise, the fixed income portfolio is broadly diversified across market segments. Small investments are also approved for private equity, real estate, and infrastructure with the objective of enhancing long-term returns while improving portfolio diversification. For the PBOP Plans, since the earnings on a portion of the assets are taxable, those investments are managed to maximize after tax returns consistent with the broad asset class parameters established by the asset allocation study. Investment risk and return are reviewed by the Company's investment committee on a quarterly basis.

The target asset allocations for the benefit plans as of March 31, 2014 and 2013 are as follows:

| | Pension Plans | | PBOP Plans | |
|---|---|---|---|---|
| | March 31, | | March 31, | |
| | **2014** | 2013 | **2014** | 2013 |
| U.S. equities | **20%** | 20% | **39%** | 39% |
| Global equities (including U.S.) | **7%** | 7% | **6%** | 6% |
| Global tactical asset allocation | **10%** | 10% | **9%** | 9% |
| Non-U.S. equities | **10%** | 10% | **21%** | 21% |
| Fixed income | **40%** | 40% | **25%** | 25% |
| Private equity | **5%** | 5% | **0%** | 0% |
| Real estate | **5%** | 5% | **0%** | 0% |
| Infrastructure | **3%** | 3% | **0%** | 0% |
| | **100%** | 100% | **100%** | 100% |

**Fair Value Measurements**

The following tables provide the fair value measurements amounts for the pension and PBOP assets.

| | March 31, 2014 | | | |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| | | *(in millions of dollars)* | | |
| **Pension Assets:** | | | | |
| Cash and cash equivalents | $ 5 | $ 116 | $ 1 | $ 122 |
| Accounts receivable | 93 | - | - | 93 |
| Accounts payable | (82) | - | - | (82) |
| Equity | 846 | 1,796 | 318 | 2,960 |
| Global tactical asset allocation | - | 244 | 54 | 298 |
| Fixed income securities | - | 2,890 | 46 | 2,936 |
| Preferred securities | 2 | - | - | 2 |
| Futures contracts | 4 | - | - | 4 |
| Private equity | - | - | 409 | 409 |
| Real estate | - | - | 310 | 310 |
| Total | **$ 868** | **$ 5,046** | **$ 1,138** | **$ 7,052** |
| **PBOP Assets:** | | | | |
| Cash and cash equivalents | $ 49 | $ 17 | $ - | $ 66 |
| Accounts receivable | 6 | - | - | 6 |
| Accounts payable | (5) | - | - | (5) |
| Equity | 460 | 1,219 | 105 | 1,784 |
| Global tactical asset allocation | 72 | 98 | 24 | 194 |
| Fixed income securities | 2 | 647 | - | 649 |
| Private equity | - | - | 8 | 8 |
| Total | **$ 584** | **$ 1,981** | **$ 137** | **$ 2,702** |

| | March 31, 2013 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | | (in millions of dollars) | | |
| **Pension Assets:** | | | | |
| Cash and cash equivalents | $ 4 | $ 102 | $ - | $ 106 |
| Accounts receivable | 141 | - | - | 141 |
| Accounts payable | (124) | - | - | (124) |
| Equity | 988 | 1,778 | 56 | 2,822 |
| Global tactical asset allocation | - | 261 | 52 | 313 |
| Fixed income securities | - | 2,697 | 56 | 2,753 |
| Preferred securities | 6 | - | - | 6 |
| Private equity | - | - | 376 | 376 |
| Real estate | - | - | 261 | 261 |
| Total | **$ 1,015** | **$ 4,838** | **$ 801** | **$ 6,654** |
| **PBOP Assets:** | | | | |
| Cash and cash equivalents | $ 94 | $ 42 | $ - | $ 136 |
| Accounts receivable | 8 | - | - | 8 |
| Accounts payable | (7) | - | - | (7) |
| Equity | 419 | 1,030 | 22 | 1,471 |
| Global tactical asset allocation | 64 | 79 | 18 | 161 |
| Fixed income securities | - | 517 | 1 | 518 |
| Private equity | - | - | 15 | 15 |
| Total | **$ 578** | **$ 1,668** | **$ 56** | **$ 2,302** |

The methods used to fair value pension and PBOP assets are described below:

**Cash and Cash Equivalents**: Cash and cash equivalents that can be priced daily are classified as Level 1. Active reserve funds, reserve deposits, commercial paper, repurchase agreements, and commingled cash equivalents are classified as Level 2. Such instruments are generally valued using a curve methodology that includes observable inputs such as money market rates for specific instruments, programs, currencies and maturity points obtained from a variety of market makers, reflective of current trading levels. The methodologies consider an instrument's days to final maturity to generate a yield based on the relevant curve for the instrument.

**Accounts Receivable and Accounts Payable:** Accounts receivable and accounts payable are classified in the same category as the investments to which they relate. Such amounts are short-term and settle within a few days of the measurement date.

**Equity and Preferred Securities:** Common stocks investment trusts are valued using the official close of the primary market on which the individual securities are traded. Equity securities are primarily comprised of securities issued by public companies in domestic and foreign markets plus investments in commingled funds, which are valued on a daily basis. The Company can exchange shares of the publicly traded securities and the fair values are primarily sourced from the closing prices on stock exchanges where there is active trading, in which case they are classified as Level 1 investments. If there is less active trading, then the publicly traded securities would typically be priced using observable data, such as bid and ask prices, and these measurements are classified as Level 2 investments. Investments that are not publicly traded and valued using unobservable inputs are classified as Level 3 investments. Commingled funds with publicly quoted prices and active trading are classified as Level 1 investments. For investments in commingled funds that are not publicly traded and have ongoing subscription and redemption activity, the fair value of the investment is the net asset value (“NAV”) per fund share, derived from the underlying securities’ quoted prices in active markets, and they are classified as Level 2 investments. Investments in commingled funds with redemption restrictions and that use NAV are classified as Level 3 investments.

**Global Tactical Asset Allocation:** Assets held in global tactical asset allocation funds are managed by investment managers who use both top-down and bottom-up valuation methodologies to value asset classes, countries, industrial sectors, and individual securities in order to allocate and invest assets opportunistically. If the inputs used to measure a financial instrument fall within different levels of the fair value hierarchy within the commingled fund, the categorization is based on the lowest level input that is significant to the measurement of that financial instrument. The assets invested through commingled funds are classified as Level 2. Those which are open ended mutual funds with observable pricing are classified as Level 1. However, the underlying Level 3 assets that makeup these funds are classified in the same category as the investments to which they relate.

**Fixed Income Securities:** Fixed income securities (which include corporate debt securities, municipal fixed income securities, U.S. Government and Government agency securities including government mortgage backed securities, index linked government bonds, and state and local bonds) convertible securities, and investments in securities lending collateral (which include repurchase agreements, asset backed securities, floating rate notes and time deposits) are valued with an institutional bid valuation. A bid valuation is an estimated price at which a dealer would pay for a security (typically in an institutional round lot). Oftentimes, these evaluations are based on proprietary models which pricing vendors establish for these purposes. In some cases there may be manual sources when primary vendors do not supply prices. Fixed income investments are primarily comprised of fixed income securities and fixed income commingled funds. The prices for direct investments in fixed income securities are generated on a daily basis. Prices generated from less active trading with wider bid ask prices are classified as Level 2 investments. If prices are based on uncorroborated and unobservable inputs, then the investments are classified as Level 3 investments. Commingled funds with publicly quoted prices and active trading are classified as Level 1 investments. For commingled funds that are not publicly traded and have ongoing subscription and redemption activity, the fair value of the investment is the NAV per fund share, derived from the underlying securities' quoted prices in active markets, and are classified as Level 2 investments. Investments in commingled funds with redemption restrictions and that use NAV are classified as Level 3.

**Private Equity and Real Estate:** Commingled equity funds, commingled special equity funds, limited partnerships, real estate, venture capital and other investments are valued using evaluations (NAV per fund share), based on proprietary models, or based on the NAV. Investments in private equity and real estate funds are primarily invested in privately held real estate investment properties, trusts, and partnerships as well as equity and debt issued by public or private companies. The Company's interest in the fund or partnership is estimated based on the NAV. The Company's interest in these funds cannot be readily redeemed due to the inherent lack of liquidity and the primarily long-term nature of the underlying assets. Distribution is made through the liquidation of the underlying assets. The Company views these investments as part of a long-term investment strategy. These investments are valued by each investment manager based on the underlying assets. The funds utilize valuation techniques consistent with the market, income, and cost approaches to measure the fair value of certain real estate investments. The majority of the underlying assets are valued using significant unobservable inputs and often require significant management judgment or estimation based on the best available information. Market data includes observations of the trading multiples of public companies considered comparable to the private companies being valued. As a result, the Company classifies these investments as Level 3.

While management believes its valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of Level 3 financial instruments could result in a different fair value measurement at the reporting date.

**Changes in Level 3 Plan Investments**

| | Pension Plans | | PBOP Plans | |
|---|---|---|---|---|
| | Years Ended March 31, | | Years Ended March 31, | |
| | **2014** | 2013 | **2014** | 2013 |
| | *(in millions of dollars)* | | | |
| Balance as of the beginning of the year | **$ 801** | $ 804 | **$ 56** | $ 73 |
| Transfers out of Level 3 | **(16)** | (4) | **(41)** | (24) |
| Transfers in to Level 3 | **282** | 6 | **102** | 27 |
| Actual gain or loss on plan assets | | | | |
| Realized gain | **37** | 17 | **3** | - |
| Unrealized gain | **56** | 37 | **(1)** | 1 |
| Purchases | **397** | 296 | **37** | 188 |
| Sales | **(419)** | (355) | **(19)** | (209) |
| Balance as of the end of the year | **$ 1,138** | $ 801 | **$ 137** | $ 56 |

*Other Benefits*

The Company accrued $83.7 million and $74.6 million at March 31, 2014 and 2013, respectively, regarding workers compensation, auto and general insurance claims which have been incurred but not yet reported.

## 9. CAPITALIZATION

*European Medium Term Note Program*

At March 31, 2014, the Company had a Euro Medium Term Note program (the "Program") under which it is able to issue debt instruments ("Instruments") up to a total of the equivalent of 4 billion Euros. Instruments issued under the Program are admitted to trading on the London Stock Exchange. The Program commenced in December 2007 and is renewed annually, with the latest renewal of the Program expiring in December 2014. If the Program is not renewed in December 2014, it would preclude the issuance of new notes under this Program, but it would not impact the outstanding debt balances and their maturity dates. Instruments carry certain affirmative and negative covenants, including a restriction on the Company's ability to mortgage, pledge, charge or otherwise encumber its assets in order to secure, guarantee or indemnify other listed or quoted debt obligations, as well as cross-acceleration in the event of breach by the Company or its principal subsidiaries of other listed or quoted debt obligations. At March 31, 2014 and 2013, the Company was in compliance with all covenants. At March 31, 2014 and 2013, $842 million and $876 million, respectively, of these notes were issued and outstanding, excluding the impact of interest rate and currency swaps.

*Notes Payable*

At March 31, 2014 and 2013 the Company had outstanding $5.9 billion and $6.1 billion, respectively, of unsecured medium and long-term notes. In December 2012, Narragansett issued $250 million of unsecured long-term debt at 4.17% with a maturity date of December 10, 2042. In November 2012, Niagara Mohawk issued $400 million of unsecured long-term debt at 4.119% with a maturity date of November 28, 2042 and $300 million of unsecured long-term debt at 2.721% with a maturity date of November 28, 2022. The interest rates on the unsecured notes range from 3.296% to 9.750% and maturity dates range from October 2014 through December 2042.

*Gas Facilities Revenue Bonds*

Brooklyn Union has outstanding tax-exempt Gas Facilities Revenue Bonds ("GFRB") issued through the New York State Energy Research and Development Authority ("NYSERDA"). There are no sinking fund requirements for any of Brooklyn Union's GFRB. At March 31, 2014 and 2013, $641 million of GFRB were outstanding; $230 million of which are variable-rate, auction rate bonds. The interest rate on the various variable rate series due starting December 1, 2020 through July 1, 2026 is reset weekly and ranged from 0.07% to 0.51% during the year ended March 31, 2014 and 0.14% to 2.17% during the year ended March 31, 2013. The GFRB are currently in auction rate mode and are backed by bond insurance. These bonds cannot be put back to Brooklyn Union and, in the case of a failed auction, the resulting interest rate on the bonds would revert to the maximum rate which depends on the current appropriate, short-term benchmark rates and the senior unsecured rating of the Brooklyn Union's bonds. The effect of the failed auctions on interest expense was not material for the years ended March 31, 2014 or 2013.

*Promissory Notes to LIPA*

KeySpan Corporation had previously issued $155 million of promissory notes to LIPA to support certain debt obligations assumed by LIPA. Following the expiration of the MSA on December 31, 2013, the debt was fully extinguished (refer to Note 17, "Discontinued Operations").

*First Mortgage Bonds*

The assets of Colonial Gas and Narragansett are subject to liens and other charges and are provided as collateral over borrowings of $75 million and $51.6 million, respectively, of non-callable First Mortgage Bonds ("FMB"). These FMB indentures include, among other provisions, limitations on the issuance of long-term debt. Interest rates range from 6.34% to 9.63% and maturity dates range from April 2018 to April 2028.

*State Authority Financing Bonds*

At March 31, 2014, the Company had outstanding $1.2 billion of State Authority Financing Bonds. Of the $1.2 billion outstanding at March 31, 2014, approximately $716 million of these bonds were issued through NYSERDA and the remaining $484 million were issued through various other state agencies.

Approximately $605 million of State Authority Financing Bonds were issued to secure a like amount of tax-exempt revenue bonds issued by NYSERDA. Approximately $530 million of such securities bear interest at short-term adjustable interest rates (with an option to convert to other rates, including a fixed interest rate) ranging from 0.38% to 0.53% for the year ended March 31, 2014. The bonds are currently in auction rate mode and are backed by bond insurance. These bonds cannot be put back to the Company and, in the case of a failed auction, the resulting interest rate on the bonds would revert to the maximum rate which depends on the current appropriate, short-term benchmark rate and the senior secured rating of the Company or the bond insurer, whichever is greater. The effect on interest expense has not been material in either of the years ended March 31, 2014 or 2013.

The Company also has $75 million of 5.15% fixed rate pollution control revenue bonds issued through NYSERDA which are callable at par. Pursuant to agreements between NYSERDA and the Company, proceeds from such issues were used for the purpose of financing the construction of certain pollution control facilities at the Company's generation facilities (which the Company subsequently sold) or to refund outstanding tax-exempt bonds and notes.

Additionally, the Company has $41 million of 1999 Series A Pollution Control Revenue Bonds due October 1, 2028. The interest rate ranged from 0.15% to 1.35% for the year ended March 31, 2014, at which time the rate was 0.61%. The interest rate ranged from 0.25% to 1.60% for the year ended March 31, 2013, at which time the rate was 0.61%. Interest expense related to these notes for each of the years ended March 31, 2014 and 2013 was approximately $0.4 million and $0.5 million, respectively.

The Company also has outstanding $25 million variable rate 1997 Series A Electric Facilities Revenue Bonds due December 1, 2027. The interest rate on these bonds is reset weekly and ranged from 0.04% to 0.25% and from 0.10% to 0.27% during the years ended March 31, 2014 and 2013, respectively. The interest rate was 0.25% and 0.12% at March 31, 2014 and 2013, respectively. Interest expense related to these notes for each of the years ended March 31, 2014 and 2013 was approximately $0.1 million.

At March 31, 2014, the Company had outstanding $410 million of the Pollution Control Revenue Bonds in tax exempt commercial paper mode with maturity dates ranging from October 2015 to October 2022 and variable interest ranging from 0.29% to 0.50% for the year ended March 31, 2014. In addition, at March 31, 2014, the Company had $52 million of tax exempt Electric Revenue Bonds in commercial paper mode with varying maturity dates from March 2016 through August 2042 and variable interest rates ranging from 0.30% to 0.50% during the year ended March 31, 2014. The bonds were issued by the Massachusetts Development Finance Agency in connection with the Company's financing of its first and second underground and submarine cable projects. Sinking fund payments of $0.3 million were made during the year ended March 31, 2014.

At March 31, 2012, three of the Company's subsidiaries had a Standby Bond Purchase Agreement ("SBPA") totaling $500 million, which expires on November 20, 2015. This agreement was available to provide liquidity support for $483 million of the Company's long-term bonds in tax-exempt commercial paper mode. The Company has classified this debt as long-term due to its intent and ability to refinance the debt on a long-term basis in the event of a failure to remarket the bonds. The Company, together with other affiliates of National Grid plc, has rights to issue debt under an $850 million syndicated revolving credit facility which can be drawn upon at any time until its maturity in November 2015 and may be used, if needed, to refinance the tax-exempt commercial paper on a long-term basis. This facility has a number of financial and non-financial covenants which the Company is obliged to meet. At March 31, 2014 and 2013, the Company was in compliance with all covenants.

*Industrial Development Revenue Bonds*

At March 31, 2014 and 2013, KeySpan Corporation had outstanding $128 million of 5.25% tax-exempt bonds due in June 2027. Of the amount, $53 million was issued through the Nassau County Industrial Development Authority for the construction of the Glenwood Energy electric-generation peaking plant and the balance of $75 million was issued by the Suffolk County Industrial Development Authority for the Port Jefferson electric-generation peaking plant. KeySpan Corporation has fully and unconditionally guaranteed the payment obligations with regard to these tax-exempt bonds.

*Committed Facility Agreements*

At March 31, 2014, the Company, NGNA, and National Grid plc have a committed revolving credit facility of $850 million which matures in November 2015. This facility, bearing a commitment fee of 0.21%, has not been drawn against and therefore there is no balance outstanding. The Company, NGNA, and National Grid plc can all draw on this facility in a variety of currencies as needed, but the aggregate borrowings across the group cannot exceed the $850 million limit. The terms of the facility restrict the borrowing of all U.S. subsidiaries of the Company to $18 billion excluding intercompany indebtedness. Additionally, this facility has a number of non-financial covenants which the Company is obliged to meet. At March 31, 2014 and 2013, the Company was in compliance with all covenants.

The Company and National Grid plc have two additional committed revolving credit facilities of $280 million and £155 million which mature in July 2017. These facilities, bear a commitment fee of 0.20% each, have not been drawn against and therefore there is no balance outstanding. The Company and National Grid plc can draw on these facilities in a variety of currencies as needed, but the aggregate borrowings across the group cannot exceed the $280 million and £155 million limit, respectively. The terms of the facilities restrict the borrowing of all U.S. subsidiaries of the Company to $18 billion excluding intercompany indebtedness. Additionally, these facilities have a number of non-financial covenants which the Company is obliged to meet. At March 31, 2014 and 2013, the Company was in compliance with all covenants.

*Debt Maturities*

The aggregate maturities of long-term debt for the years subsequent to March 31, 2014 are as follows:

| *(in millions of dollars)* | | |
|---|---|---|
| Years Ended March 31, | | |
| 2015 | $ | 633 |
| 2016 | | 891 |
| 2017 | | 511 |
| 2018 | | 89 |
| 2019 | | 36 |
| Thereafter | | 6,679 |
| Total | $ | 8,839 |

The Company is obligated to meet certain financial and non-financial covenants. The Company's subsidiaries also have restrictions on the payment of dividends which relate to their debt to equity ratios. During the years ended March 31, 2014 and 2013 the Company was in compliance with all such covenants and restrictions.

Some of the Company's State Authority Financing Bonds, First Mortgage Bonds, and Notes Payable have sinking fund requirements which totaled $7 million during the years ended March 31, 2014 and 2013. The following table reflects the sinking fund repayment requirements for the years subsequent to March 31, 2014:

| *(in millions of dollars)* | | |
|---|---|---|
| Years Ended March 31, | | |
| 2015 | $ | 2 |
| 2016 | | 2 |
| 2017 | | 1 |
| 2018 | | 1 |
| 2019 | | 1 |
| Thereafter | | 8 |
| Total | $ | 15 |

**Commercial Paper and Revolving Credit Agreements**

*Commercial Paper*

At March 31, 2014, the Company had two commercial paper programs totaling $4 billion; a $2 billion U.S. commercial paper program and a $2 billion Euro commercial paper program. In support of these programs, the Company was a named borrower under National Grid plc credit facilities with $1.4 billion available to the Company. These facilities support both the Parent's and the Company's commercial paper programs for ongoing working capital needs. The facilities expire in 2015 to 2017. At March 31, 2014 and 2013, there were $421 million and $625 million of borrowings outstanding on the U.S. commercial paper program and no borrowings outstanding on the Euro commercial paper program.

The credit facilities allow both the Parent and the Company to borrow in multi-currencies. The current annual commitment fees range from 0.20% to 0.21%. If for any reason the Company were not able to issue sufficient commercial paper or source funds from other sources, the facilities could be drawn upon to meet cash requirements. The facilities contain certain affirmative and negative operating covenants, including restrictions on the Company's utility subsidiaries' ability to mortgage, pledge, encumber or otherwise subject their utility property to any lien, as well as financial covenants that require the Company and the Parent to limit the total indebtedness in U.S. and non-U.S. subsidiaries to pre-defined limits. Violation of these covenants could result in the termination of the facilities and the required repayment of amounts borrowed thereunder, as well as possible cross defaults under other debt agreements. At March 31, 2014 and 2013, the Company was in compliance with all covenants.

## 10. INCOME TAXES

### Components of Income Tax Expense

| | Years Ended March 31, 2014 | Years Ended March 31, 2013 |
|---|---|---|
| | *(in millions of dollars)* | |
| Current tax expense (benefit): | | |
| Federal | **$ (18)** | $ (208) |
| State | **40** | 53 |
| Total current tax expense (benefit) | **22** | (155) |
| Deferred tax expense: | | |
| Federal | **254** | 388 |
| State | **6** | 45 |
| Total deferred tax expense | **260** | 433 |
| Amortized investment tax credits (1) | **(5)** | (6) |
| Total deferred tax expense | **255** | 427 |
| Total income tax expense | **$ 277** | $ 272 |

(1) Investment tax credits ("ITC") are being deferred and amortized over the depreciable life of the property giving rise to the credits.

### Statutory Rate Reconciliation

The Company's effective tax rates for the years ended March 31, 2014 and 2013 were 36.3% and 39.5%, respectively. The following table presents a reconciliation of income tax expense at the federal statutory tax rate of 35% to the actual tax expense:

| | Years Ended March 31, 2014 | Years Ended March 31, 2013 |
|---|---|---|
| | *(in millions of dollars)* | |
| Computed tax | **$ 267** | $ 241 |
| Change in computed taxes resulting from: | | |
| State income tax, net of federal benefit | **30** | 62 |
| Investment tax credit | **(5)** | (6) |
| Other items, net | **(15)** | (25) |
| Total | **10** | 31 |
| Federal and state income taxes | **$ 277** | $ 272 |

The Company is included in the NGNA and subsidiaries consolidated federal income tax return. The Company has joint and several liability for any potential assessments against the consolidated group. The Company also files unitary, combined, and separate state income tax returns.

In September 2013, the IRS issued final regulations, effective for tax years beginning in 2014, that provide guidance on the appropriate tax treatment of costs incurred to acquire, produce or improve tangible property, as well as routine maintenance and repair costs. Proposed regulations were issued addressing the tax treatment of asset dispositions. The Company has evaluated tax accounting method changes that may be elected or required by the final regulations. At March 31, 2014, $43.5 million of deferred tax liabilities have been classified as current in the Company's consolidated balance sheets, representing the cumulative adjustment expected to be reflected in income for tax purposes during the twelve months ending March 31, 2015. The application of these regulations is not expected to have a material impact on the Company's financial position, results of operations, or cash flows.

On July 24, 2013, the Massachusetts legislature enacted into law transportation finance legislation which included significant tax changes affecting the classification of utility corporations. For tax years beginning on or after January 1, 2014, Massachusetts utility corporations will be taxed in the same manner as general business corporations. The state income tax rate increased from 6.5% to 8.0%. Also, any unitary net operating loss generated post-2013 and allocated to the utilities will be allowed as a carryforward tax attribute. As of March 31, 2014, all Massachusetts state deferred tax balances at the regulated utilities were remeasured to the 8% rate, resulting in an increase in deferred tax liabilities of $47 million with an offset to the regulatory deferred tax asset. The application of this legislation is not expected to have a material impact on the Company's financial position, results of operations, or cash flows.

On March 31, 2014, New York's legislature enacted as part of the 2014-15 budget package, legislation which included significant tax changes. For tax years beginning on or after January 1, 2016, the New York corporate franchise rate is reduced from 7.1% to 6.5%. Additionally, for tax years beginning on or after January 1, 2015, New York State will generally require combined reporting if the taxpayer is engaged in a unitary business and a 50% common ownership test is met. The Metropolitan Transportation Authority surcharge rate increased from 17% to 25.6% of the New York rate for taxable years beginning after 2014 and before 2016. For subsequent years, the rate is to be adjusted by the Commissioner of the New York State Department of Taxation and Finance. As of March 31, 2014, the Company remeasured its New York State deferred tax assets and liabilities based upon the enacted law that will apply when the corresponding state temporary differences are expected to be realized or settled. Specifically, the Company decreased its New York State deferred tax liability and income tax expense by $24.5 million and $3.1 million, respectively, with an offset of $27.6 million to the regulatory deferred tax liability.

**Deferred Tax Components**

| | March 31, | |
|---|---|---|
| | **2014** | 2013 |
| | *(in millions of dollars)* | |
| Deferred tax assets: | | |
| Pensions, PBOP and other employee benefits | **$ 1,514** | $ 1,821 |
| Reserve - environmental response costs | **563** | 580 |
| Regulatory liabilities - other | **326** | 398 |
| Future federal benefit on state taxes | **176** | 173 |
| Net operating losses | **242** | 297 |
| Other items | **210** | 274 |
| Total deferred tax assets [1] | **3,031** | 3,543 |
| Deferred tax liabilities: | | |
| Property related differences | **5,615** | 5,248 |
| Regulatory assets - pension and PBOP | **722** | 875 |
| Regulatory assets - environmental | **681** | 692 |
| Regulatory assets - other | **432** | 479 |
| Other items | **223** | 249 |
| Total deferred tax liabilities | **7,673** | 7,543 |
| Net deferred income tax liabilities | **4,642** | 4,000 |
| Deferred investment tax credits | **37** | 45 |
| Net deferred income tax liability and investment tax credits | **4,679** | 4,045 |
| Current portion of deferred income tax liabilities | **171** | 193 |
| Deferred income tax liabilities | **$ 4,850** | $ 4,238 |

(1) There was a valuation allowance of zero and $5.8 million for deferred tax assets at March 31, 2014 and 2013, respectively.

The following table presents the amounts and expiration dates of operating losses as of March 31, 2014:

| Expiration of net operating losses: | Federal |
|---|---|
| | *(in millions of dollars)* |
| 03/31/2033 | $ 535 |
| 03/31/2034 | 509 |

| Expiration of state and city net operating losses: | State of New York | City of New York |
|---|---|---|
| | *(in millions of dollars)* | |
| 12/31/2024 | $ 49 | $ 38 |
| 12/31/2025 | 88 | 82 |
| 12/31/2026 | 24 | - |
| 12/31/2027 | 35 | - |
| 03/31/2028 | 47 | 7 |
| 03/31/2029 | 295 | 37 |
| 03/31/2030 | 70 | 28 |
| 03/31/2031 | 11 | - |
| 03/31/2032 | 41 | 10 |
| 03/31/2033 | 387 | 295 |
| 03/31/2034 | 90 | - |

**Unrecognized Tax Benefits**

As of March 31, 2014 and 2013, the Company's unrecognized tax benefits totaled $510 million and $662 million, respectively, of which $65 million and $80 million, respectively, would affect the effective tax rate, if recognized. The unrecognized federal tax benefits are included in other non-current liabilities in the accompanying consolidated balance sheets.

The following table presents changes to the Company's unrecognized tax benefits:

| | Years Ended March 31, | |
|---|---|---|
| | **2014** | 2013 |
| | *(in millions of dollars)* | |
| Balance as of the beginning of the year | **$ 662** | $ 713 |
| Gross increases related to prior period | **52** | 16 |
| Gross decreases related to prior period | **(63)** | (77) |
| Gross increases related to current period | **53** | 41 |
| Gross decreases related to current period | **-** | (27) |
| Settlements with tax authorities | **(194)** | (4) |
| Balance as of the end of the year | **$ 510** | $ 662 |

As of March 31, 2014 and 2013, the Company has accrued for interest related to unrecognized tax benefits of $55.3 million and $71 million, respectively. During the years ended March 31, 2014 and 2013, the Company recorded interest expense of $12.4 million and $0.4 million, respectively. The Company recognizes interest related to unrecognized tax benefits in other interest, including affiliate interest and related penalties, if applicable, in other deductions, net in the accompanying consolidated statements of income. No tax penalties were recognized during the years ended March 31, 2014 and 2013.

It is reasonably possible that other events will occur during the next twelve months that would cause the total amount of unrecognized tax benefits to increase or decrease. However, the Company does not believe any such increases or decreases would be material to its results of operations, financial position, or cash flows.

During fiscal year 2014, the IRS concluded its examination of the NGNA consolidated filing group's corporate income tax returns, which includes corporate income tax returns of KeySpan Corporation and subsidiaries for the short period ended August 24, 2007, and of NGNA and subsidiaries for the periods ended March 31, 2008 and 2009. These examinations were completed on March 27, 2014 and March 31, 2014, respectively, with an agreement on the majority of income tax issues for the years referenced above, as well as an acknowledgment that certain discrete items remain disputed. NGNA is in the process of appealing these disputed issues with the IRS Office of Appeals. The Company does not anticipate a change in its unrecognized tax positions in the next twelve months as a result of the appeals. However, pursuant to the Company's tax sharing agreement, the audit or appeals may result in a change to allocated tax.

The years ended March 31, 2010 through March 31, 2014 remain subject to examination by the IRS.

The Company is a member of the NGUSA Service Company Massachusetts unitary group since fiscal year ended March 31, 2010. The tax returns for the fiscal years ended March 31, 2010 through March 31, 2014 remain subject to examination by the State of Massachusetts.

The following table indicates the earliest tax year subject to examination:

| Jurisdiction | Tax Year |
|---|---|
| Federal | August 24, 2007 * |
| Massachusetts | March 31, 2003 |
| New York | December 31, 2003 |
| New York City | December 31, 2003 |
| New Hampshire | March 31, 2009 |

* The NGNA consolidated filing group is in the process of appealing certain disputed issues with the IRS Office of Appeals for the years ended March 31, 2008 through March 31, 2009.

The Company is in the process of appealing adjustments made by the Massachusetts Department of Revenue ("MADOR") for the years ended March 31, 2003 through March 31, 2005. The Company is currently under audit by the MADOR for years ended March 31, 2006 through March 31, 2008.

During the fiscal year, the Company settled examinations for KeySpan Corporation and subsidiaries income tax returns for the years 2000 through 2002, and Wayfinder Group Inc. for the year ended March 31, 2008 with the State of New York and made payments for tax and interest of $3.4 million and $4.3 million, respectively.

The State of New York is in the process of examining the Company's NYS income tax returns for KeySpan Gas East for the period January 1, 2003 through March 31, 2008, and for Brooklyn Union for the period January 1, 2007 through March 31, 2008. The tax returns for the years ended March 31, 2009 through March 31, 2014 remain subject to examination by the State of New York. The Company has filed New York ITC claims for the New York Gas Companies for the tax years ended December 31, 2002 through March 31, 2010. New York State has disallowed the claims for December 31, 2002 through December 31, 2006 upon audit, and also denied them on appeal to the New York Tax Tribunal, which decision was further appealed to the Supreme Court, Appellate Division. On June 6, 2013, the Company received an adverse decision from the Supreme Court, Appellate Division, and made tax and interest payments of $29.7 million and $19.9 million, respectively, during the year ended March 31, 2014.

New York State and New York City are in the process of an examining the returns of KeySpan Corporation and subsidiaries for the period January 1, 2003 through March 31, 2008 and January 1, 2003 through December 31, 2005, respectively.

The State of New York is in the process of examining the Niagara Mohawk Holdings Inc. and subsidiaries combined returns for the years ended March 31, 2006 through March 31, 2008.

## 11. GOODWILL

The following table represents the changes in the carrying amount of goodwill for the years ended March 31, 2014 and 2013:

| | Years Ended March 31, | |
|---|---|---|
| | **2014** | 2013 |
| | *(in millions of dollars)* | |
| Balance as of the beginning of the year | **$ 7,151** | $ 7,133 |
| Consolidation of variable interest entity | - | 20 |
| Revaluation in relation to Granite State | - | (1) |
| Regulatory recovery | - | (1) |
| Balance as of the end of the year | **$ 7,151** | $ 7,151 |

In January 2013, the Company made an investment in Clean Line Energy Partners LLC ("Clean Line"). Clean Line is a development-stage entity engaged in the development of long distance, high voltage direct current transmission lines that connect wind farms and other renewable resources in remote parts of the United States with electric demand. The Company committed to a $40 million investment in Clean Line, of which the Company contributed $12.5 million during the year ended March 31, 2013 and contributed the remaining $27.5 million during the year ended March 31, 2014. Based on an analysis of the contractual terms and rights contained in the related agreements, the Company determined that under the applicable accounting standards, Clean Line is a variable interest entity and the Company has effective control over the entity. Therefore, as the primary beneficiary, the Company has consolidated Clean Line. Upon consolidation, the Company recognized approximately $20 million of goodwill.

Colonial Gas has authority from the DPU to recover $234.8 million of goodwill ($141.5 million of acquisition premium, plus tax of $93.3 million). The regulatory asset for the recovery of the acquisition premium was $208.4 million at March 31, 2014, and will be amortized on a straight-line basis as it is recovered through rates at $8.2 million per year through August 2039.

The net regulatory recovery adjustments of $1 million shown in the table above include, with respect to Colonial Gas: (1) a reclassification adjustment of $5 million from regulatory assets to goodwill in order to correct these balances and properly reflect the authorized recovery period of acquisition premium under DPU 10-55, and (2) a reclassification adjustment of ($6.0) million from goodwill to regulatory assets related to a ruling by the DPU in January 2013.

## 12. ENVIRONMENTAL MATTERS

The normal ongoing operations and historic activities of the Company are subject to various federal, state and local environmental laws and regulations. Under federal and state Superfund laws, potential liability for the historic contamination of property may be imposed on responsible parties jointly and severally, without regard to fault, even if the activities were lawful when they occurred.

On April 26, 2013, General Electric ("GE") filed a lawsuit against Niagara Mohawk seeking contribution under the Comprehensive Environmental Response, Compensation, and Liability Act for an unspecified portion of GE's alleged response costs incurred in remediating polychlorinated biphenyl ("PCB") contamination in the Hudson River. GE alleges that Niagara Mohawk's removal of the Fort Edward Dam in 1973 resulted in the migration of sediments, contaminated with PCBs released into the environment by GE, downstream of the former dam's location. On June 25, 2013, Niagara Mohawk answered GE's complaint denying liability. The parties executed a confidential settlement agreement on December 13, 2013. By stipulation of the parties and Court order, GE's claims against Niagara Mohawk were dismissed with prejudice on January 13, 2014.

*Air*

National Grid Generation's generating facilities are subject to increasingly stringent emissions limitations under current and anticipated future requirements of the United States Environmental Protection Agency ("EPA") and the DEC. In addition to efforts to improve both ozone and particulate matter air quality, there has been an increased focus on greenhouse gas emissions in recent years. National Grid Generation's previous investments in low NOx boiler combustion modifications, the use of natural gas firing systems at its steam electric generating stations, and the compliance flexibility available under cap and trade programs have enabled National Grid Generation to achieve its prior emission reductions in a cost-effective manner. Recently completed investments include the installation of enhanced NOx controls and efficiency improvement projects at certain of National Grid Generation's Long Island based electric generating facilities. The total cost of these improvements was approximately $103 million, all of which have been placed in service as of the date of this report; a mechanism for recovery from LIPA of these investments has been established. National Grid Generation has developed a compliance strategy to address anticipated future requirements, and is closely monitoring the regulatory developments to identify any necessary changes to its compliance strategy. At this time, the Company is unable to predict what effect, if any, these future requirements will have on its consolidated financial position, results of operations, and cash flows.

*Water*

Additional capital expenditures associated with the renewal of the surface water discharge permits for National Grid Generation's power plants will likely be required by the DEC at each of the Long Island power plants pursuant to Section 316 of the Clean Water Act to mitigate the plants' alleged cooling water system impacts to aquatic organisms. National Grid Generation is currently engaged in discussions with the DEC and environmental groups regarding the nature of capital upgrades or other mitigation measures necessary to reduce any impacts. Although these discussions have been productive and have led to mutually agreeable final permits at some of the plants, it is possible that the determination of required capital improvements and the issuance of final renewal permits for the remaining plants could involve adjudicatory hearings among National Grid Generation, the agency, and the environmental groups. Capital costs for expected mitigation requirements at the plants had been estimated on the order of approximately $100 million and do not anticipate a need for cooling towers at any of the plants. Depending on the outcome of the adjudicatory process, which could extend beyond the next fiscal year, ultimate costs could be substantially higher. Costs associated with any finally ordered capital improvements would be reimbursable from LIPA under the PSA.

*Land, Manufactured Gas Plants and Related Facilities*

Federal and state environmental regulators, as well as private parties, have alleged that several of the Company's subsidiaries are potentially responsible parties under Superfund laws for the remediation of numerous contaminated sites in New York and New England. The Company's greatest potential Superfund liabilities relate to MGP facilities formerly owned or operated by its subsidiaries or their predecessors. MGP byproducts included fuel oils, hydrocarbons, coal tar, purifier waste and other waste products which may pose a risk to human health and the environment.

Since July 12, 2006, several lawsuits have been filed which allege damages resulting from contamination associated with the historic operations of a former manufactured gas plant located in Bay Shore, New York. KeySpan has been conducting a remediation at this location pursuant to Administrative Order on Consent ("ACO") with the New York State Department of Environmental Conservation ("DEC"). KeySpan intends to contest these proceedings vigorously.

On February 8, 2007, the Company received a Notice of Intent to File Suit from the AG against KeySpan and four other companies in connection with the cleanup of historical contamination found in certain lands located in Greenpoint, Brooklyn and in an adjoining waterway. KeySpan has previously agreed to remediate portions of the properties referenced in this notice and will work cooperatively with the DEC and AG to address environmental conditions associated with the remainder of the properties. KeySpan has entered into an ACO with the DEC for the land-based sites. The EPA assumed control of the waterway and, on September 29, 2010, listed this site on its National Priorities List of Superfund sites. The Company signed a consent decree with the EPA on July 7, 2011 and is currently performing a Remedial Investigation and Feasibility Study. At this time, the Company is unable to predict what effect, if any, the outcome of these proceedings will have on its consolidated financial position, results of operations, and cash flows.

*Utility Sites*

At March 31, 2014, the Company's total reserve for estimated MGP-related environmental matters is $1.3 billion. The potential high end of the range at March 31, 2014 is presently estimated at $2.0 billion on an undiscounted basis. Management believes that obligations imposed on the Company because of the environmental laws will not have a material adverse effect on its operations, financial position, or cash flows. Through various rate orders issued by the NYPSC, DPU, and RIPUC, costs related to MGP environmental cleanup activities are recovered in rates charged to gas distribution customers. Accordingly, the Company has reflected a regulatory asset of $1.7 billion and $1.8 billion on the consolidated balance sheets at March 31, 2014 and 2013, respectively.

Upon the acquisition of KeySpan by NGUSA, the Company recognized those environmental liabilities at fair value. The fair values included discounting of the reserve, which is being accreted over the period for which remediation is expected to occur. Following the acquisition of KeySpan, these environmental liabilities are recognized in accordance with the current accounting guidance for environmental obligations.

The Company is pursuing claims against other potentially responsible parties to recover investigation and remediation costs it believes are the obligations of those parties. The Company cannot predict the likelihood of success of such claims.

*Non-Utility Sites*

The Company is aware of two non-utility sites for which it may have, or share, environmental remediation or ongoing maintenance responsibility. Expenditures incurred were approximately $2 million and $1 million for the years ended March 31, 2014 and 2013, respectively. The Company presently estimates the remaining cost of the environmental cleanup activities for these two non-utility sites will be approximately $24 million and $22 million, which has been accrued at March 31, 2014 and 2013, respectively. The Company's environmental obligation is net of a discount rate of 6.5%, and the undiscounted amount totaled $29 million and $27 million in liabilities at March 31, 2014 and 2013, respectively. The Company believes this to be a reasonable estimate of probable costs for known sites; however, remediation costs for each site may be materially higher than noted, depending upon changing technologies and regulatory standards, selected end use for each site, and actual environmental conditions encountered.

The Company believes that in the aggregate, the accrued liability for all of the sites and related facilities identified above are reasonable estimates of the probable cost for the investigation and remediation of these sites and facilities. As circumstances warrant, the Company periodically re-evaluates the accrued liabilities associated with MGP sites and related facilities. The Company may be required to investigate and, if necessary, remediate each site previously noted, or other currently unknown former sites and related facility sites, the cost of which is not presently determinable.

The Company believes that its ongoing operations, and its approach to addressing conditions at historic sites, are in substantial compliance with all applicable environmental laws, and that the obligations imposed on it because of the environmental laws will not have a material impact on its results of operations or financial position since, as noted above, environmental expenditures incurred by the Company are generally recoverable from customers.

## 13. COMMITMENTS AND CONTINGENCIES

*Operating Lease Obligations*

The Company has various operating leases for buildings, office equipment, vehicles and power operating equipment utilized by both the Company and its subsidiaries. Total rental expense for operating leases included in operations and maintenance expense in the accompanying consolidated statements of income was $121 million and $105 million for the years ended March 31, 2014 and 2013, respectively.

The future minimum lease payments for the years subsequent to March 31, 2014 are as follows:

| *(in millions of dollars)* | | |
|---|---|---|
| Years Ending March 31, | | |
| 2015 | $ | 97 |
| 2016 | | 98 |
| 2017 | | 98 |
| 2018 | | 99 |
| 2019 | | 86 |
| Thereafter | | 404 |
| Total | $ | 882 |

*Energy Purchase and Capital Expenditure Commitments*

The Company's electric subsidiaries have several long-term contracts for the purchase of electric power. Substantially all of these contracts require power to be delivered before the subsidiaries are obligated to make payment. The Company's gas distribution subsidiaries have entered into various contracts for gas delivery, storage and supply services. Certain of these contracts require payment of annual demand charges. The Company's gas distribution subsidiaries are liable for these payments regardless of the level of services required from third-parties. Such charges are currently recovered from customers as gas costs. In addition, the Company has various capital commitments related to the construction of property, plant, and equipment.

The Company's commitments under these long-term contracts for the years subsequent to March 31, 2014 are summarized in the table below:

| *(in millions of dollars)*<br>Years Ending March 31, | Energy Purchases | | Capital Expenditures | |
|---|---|---|---|---|
| 2015 | $ | 2,087 | $ | 489 |
| 2016 | | 859 | | 46 |
| 2017 | | 632 | | 41 |
| 2018 | | 483 | | 50 |
| 2019 | | 391 | | 34 |
| Thereafter | | 1,806 | | - |
| Total | $ | 6,258 | $ | 660 |

The Company's subsidiaries can purchase additional energy to meet load requirements from independent power producers, other utilities, energy merchants or on the open market through the NYISO or the ISO-NE at market prices.

Pursuant to the PSA, the Company is required to invest in capital improvements in accordance with prudent utility practice. Such investments may approach the range of $500 million to $590 million subject to certain provisions in the contract.

**Financial Guarantees**

The Company has guaranteed the principal and interest payments on certain outstanding debt of its subsidiaries. Additionally, the Company has issued financial guarantees in the normal course of business, on behalf of its subsidiaries, to various third-party creditors. At March 31, 2014, the following amounts would have to be paid by the Company in the event of non-payment by the primary obligor at the time payment is due:

| Guarantees for Subsidiaries: | | Amount of Exposure | Expiration Dates |
|---|---|---|---|
| | | *(in millions of dollars)* | |
| Industrial Development Revenue Bonds | (i) | $ 128 | June 2027 |
| KeySpan Ravenswood LLC Lease | (ii) | 387 | May 2040 |
| Reservoir Woods | (iii) | 229 | October 2029 |
| Surety Bonds | (iv) | 195 | Revolving |
| Commodity Guarantees and Other | (v) | 95 | October 2015 - August 2042 |
| Letters of Credit | (vi) | 203 | May 2014 - December 2014 |
| | | $ 1,237 | |

The following is a description of the Company's outstanding subsidiary guarantees:

(i) KeySpan has fully and unconditionally guaranteed the payment obligations of its subsidiaries with regard to $128 million of Industrial Development Revenue Bonds issued through the Nassau County and Suffolk County Industrial Development Authorities for the construction of two electric-generation peaking plants on Long Island, New York. The face value of these notes is included in long-term debt in the accompanying consolidated balance sheets.

(ii) The Company had guaranteed all payment and performance obligations of a former subsidiary (KeySpan Ravenswood LLC) associated with a merchant electric generating facility leased by that subsidiary under a sale/leaseback arrangement. The subsidiary and the facility were sold in 2008. However, the original lease remains in place and the Company will continue to make the required payments under the lease through 2040. The cash consideration from the buyer of the facility included the remaining lease payments on a net present value basis. At March 31, 2014, the Company's obligation related to the lease was $387 million and is reflected in other non-current liabilities in the accompanying consolidated balance sheets.

(iii) The Company has fully and unconditionally guaranteed $229 million in lease payments through 2029 related to the lease of office facilities by its service company at Reservoir Woods in Waltham, Massachusetts.

(iv) The Company has agreed to indemnify the issuers of various surety bonds associated with various construction requirements or projects of its subsidiaries. In the event that the Company or its subsidiaries fail to perform their obligations under contracts, the injured party may demand that the surety make payments or provide services under the bond. The Company would then be obligated to reimburse the surety for any expenses or cash outlays it incurs.

(v) The Company has guaranteed commodity-related payments for certain subsidiaries. These guarantees are provided to third-parties to facilitate physical and financial transactions involved in the purchase and transportation of natural gas, oil and other petroleum products for gas and electric production and marketing activities. The guarantees cover actual purchases by these subsidiaries that are still outstanding as of March 31, 2014.

(vi) The Company has arranged for stand-by letters of credit to be issued to third-parties that have extended credit to certain subsidiaries. Certain vendors require the posting of letters of credit to guarantee subsidiary performance under the Company's contracts and to ensure payment to the Company's subsidiary subcontractors and vendors under those contracts. Certain of the Company's vendors also require letters of credit to ensure reimbursement for amounts they are disbursing on behalf of the Company's subsidiaries, such as to beneficiaries under the Company's self-funded insurance programs. Such letters of credit are generally issued by a bank or similar financial institution. The letters of credit commit the issuer to pay specified amounts to the holder of the letter of credit if the holder demonstrates that the Company has failed to perform specified actions. If this were to occur, the Company would be required to reimburse the issuer of the letter of credit.

As of the date of this report, the Company has not had a claim made against it for any of the above guarantees and has no reason to believe that the Company's subsidiaries or former subsidiaries will default on their current obligations. However, the Company cannot predict when, or if, any defaults may take place or the impact any such defaults may have on its consolidated results of operations, financial position, or cash flows.

The Company has guaranteed $210 million of an $800 million Millennium Pipeline construction loan. The $210 million represents the Company's proportionate share of the $800 million loan based on the Company's 26.25% ownership interest in the Millennium Pipeline project.

**Long-Term Contracts for Renewable Energy**

*Town of Johnston Project*

In June 2010, pursuant to 2009 Rhode Island legislation that required Narragansett to negotiate a contract for an electric generating project fueled by landfill gas from the Rhode Island Central Landfill Narragansett entered into a contract with Rhode Island LFG Genco for the Town of Johnston Project, a combined cycle power plant with an average output of 32 megawatts ("MW"). The facility reached commercial operation on May 28, 2013 and is being accounted for as an operating lease.

*Deepwater Agreement*

The 2009 law also required Narragansett to solicit proposals for a small scale renewable energy generation project of up to eight wind turbines with an aggregate nameplate capacity of up to 30 MW to benefit the Town of New Shoreham. The renewable energy generation project also included a transmission cable to be constructed between Block Island and the mainland of Rhode Island. On June 30, 2010, Narragansett entered into a 20-year Amended Power Purchase Agreement ("PPA") with Deepwater Wind Block Island LLC, which was approved by the RIPUC in August 2010. Narragansett also negotiated a Transmission Facilities Purchase Agreement ("Facilities Purchase Agreement") with Deepwater Wind Block Island Transmission, LLC ("Deepwater") to purchase from Deepwater the permits, engineering, real estate, and other site development work for construction of the undersea transmission cable. On April 2, 2014, the Division issued its Consent Decision for Narragansett to execute the Facilities Purchase Agreement with Deepwater. Narragansett intends to make a filing with the FERC to recover the costs associated with the cable in transmission rates.

**Legal Matters**

The Company is subject to various legal proceedings, primarily injury claims, arising out of the ordinary course of its business. The Company does not consider any of such proceedings to be material, individually or in the aggregate, to its business or likely to result in a material adverse effect on its results of operations, financial position, or cash flows.

*FERC ROE Complaints*

On September 30, 2011, several state and municipal parties in New England, ("Complainants"), filed a complaint against certain New England Transmission Owners, ("NETOs") including NEP, to lower the base ROE for transmission rates in New England from 11.14% to 9.2 %. On August 6, 2013, a FERC Administrative Law Judge ("ALJ") issued an Initial Decision finding that the base ROE for the refund period and the prospective period should be 10.6% and 9.7%, respectively, prior to any adjustments in a final FERC order. The refund period is the 15-month period from October 1, 2011 through December 31, 2012; the prospective period begins when the FERC issues its final order. In response to the ALJ's Initial Decision, NEP recorded an estimated reduction to revenues of $7.1 million and an increase to interest expense of $0.2 million for the fiscal year ended March 31, 2013, reflecting an effective ROE of 10.6% for the portion that would be refunded to transmission customers for the refund period. On June 19, 2014, the FERC issued an order modifying the ALJ's findings and its previous methodology for establishing ROE. The FERC tentatively set the ROE at 10.57% and capped the ROE for incentive rates of return to 11.74% subject to further proceedings to establish and quantify growth rates applicable to the ROE. In response, NEP recorded an additional reduction to revenues of $1.2 million and an increase of $0.2 million to interest expense for the fiscal year ended March 31, 2014.

On December 27, 2012, a new ROE complaint was filed against the NETOs by a coalition of consumers seeking to lower the base ROE for New England transmission rates to 8.7% effective as of December 27, 2012. On June 19, 2014, the FERC issued an order setting the complaint for investigation and a trial-type, evidentiary hearing. The FERC stated that it expects parties to present evidence and any discounted cash flow analyses, as guided by the rulings found in FERC's June 19 order on the first complaint.

On July 31, 2014, a third ROE Complaint was filed against the NETOs by the Complainants. The FERC has not yet acted on this complaint.

**Electric Services and LIPA Agreements**

Effective May 23, 2013, National Grid Generation provides services to LIPA under an amended and restated PSA. Under the PSA, National Grid Generation has a revenue requirement of $418.6 million, a return on equity of 9.75% and a capital structure of 50% debt and 50% equity. The PSA has a term of fifteen years, provided LIPA has the option to terminate the agreement as early as April 2025 on two years advance notice. National Grid Generation accounts for the PSA as an operating lease.

The PSA provides potential penalties to National Grid Generation if it does not maintain the output capability of the generating facilities, as measured by annual industry-standard tests of operating capability, plant availability, and efficiency. These penalties may total $4.0 million annually. Although the PSA provides LIPA with all of the capacity from the generating facilities, LIPA has no obligation to purchase energy from the generating facilities and can purchase energy on a least-cost basis from all available sources consistent with existing transmission interconnection limitations of the transmission and distribution system. National Grid Generation must, therefore, operate its generating facilities in a manner such that the Company can remain competitive with other producers of energy. To date, National Grid Generation has dispatched to LIPA and LIPA has accepted the level of energy generated at the agreed to price per megawatt hour. Under the terms of the PSA, LIPA is obligated to pay for capacity at rates that reflect recovery of an agreed level of the overall cost of maintaining and operating the generating facilities, including recovery of depreciation and return on its investment in plant. A monthly variable maintenance charge is billed for each unit of energy actually acquired from the generating facilities. The billings to LIPA under the PSA do not include a provision for fuel costs, as such fuel is owned by LIPA.

In June 2011, LIPA and National Grid Generation executed an amendment to the then-current PSA pursuant to which the parties agreed that LIPA would reduce purchases of capacity from specified generating facilities, specifically the Glenwood and Far Rockaway, New York steam facilities. The Company has retired these generating facilities and removed them from the PSA and is in the process of dismantling these facilities. As part of this amendment, National Grid Generation paid an Economic Equivalent Payment ("EEP") of $18.0 million which represented the economic benefit to LIPA which would have been realized under the original agreement. Half of the EEP was paid on July 3, 2012, with the remaining balance on May

28, 2013. The EEP was accrued on a straight-line basis over the 24-month term, from June 2011 through May 2013, as a reduction in operating revenues.

Pursuant to the EMA, the Company procured and managed fuel supplies for LIPA to fuel the Company's Long Island based generating facilities. In exchange for these services, the Company earned an annual fee of $750,000. The EMA expired on May 28, 2013. LIPA did not renew the EMA contract with the Company.

**Decommissioning Nuclear Units**

NEP has minority interests in three nuclear generating companies: Yankee Atomic Electric Company ("Yankee Atomic"), Connecticut Yankee Atomic Power Company ("Connecticut Yankee"), and Maine Yankee Atomic Power Company ("Maine Yankee") (together, the "Yankees"). These ownership interests are accounted for on the equity method. The Yankees operated nuclear generating units which have been permanently decommissioned. Spent nuclear fuel remains on each site, awaiting fulfillment by the U.S. Department of Energy ("DOE") of its statutory obligation to remove it. In addition, groundwater monitoring is ongoing at each site. Future estimated billings, which are included in other deferred liabilities and other current liabilities in the accompanying consolidated balance sheets, are as follows:

| *(in thousands of dollars)* | The Company's Investment as of March 31, 2014 | | | | Future Estimated Billings to the Company | |
|---|---|---|---|---|---|---|
| Unit | % | | Amount | Date Retired | | Amount |
| Yankee Atomic | 34.5 | $ | 529 | Feb 1992 | $ | 3,877 |
| Connecticut Yankee | 19.5 | | 303 | Dec 1996 | | 18,090 |
| Maine Yankee | 24.0 | | 564 | Aug 1997 | | 10,947 |

The Yankees are periodically required to file rate cases for FERC review, which present the Yankees' estimated future decommissioning costs. The Yankees collect the approved costs from their purchasers, including NEP. Future estimated billings from the Yankees are based on cost estimates. These estimates include the projections of groundwater monitoring, security, liability and property insurance and other costs. They also include costs for interim spent fuel storage facilities which the Yankees have constructed while they await removal of the fuel by the DOE as required by the Nuclear Waste Policy Act of 1982 and contracts between the DOE and each of the Yankees. NEP has recorded a liability and a regulatory asset reflecting the estimated future decommissioning billings from the Yankees.

In 2013, the FERC accepted settlements establishing rate mechanisms by which each of the Yankees maintains funding for operations and decommissioning and credits to its purchasers, including NEP, any net proceeds in excess of funding costs received as part of the DOE litigation proceedings discussed below.

Each of the Yankees brought litigation against the DOE for failure to remove their respective nuclear fuel stores as required by the Nuclear Waste Policy Act and contracts. Following a trial at the U.S. Court of Claims ("Claims Court") to determine the level of damages, on October 4, 2006, the Claims Court awarded the three companies an aggregate of $143 million for spent fuel storage costs that had been incurred through 2001 and 2002 (the "Phase I Litigation"). The Yankees had requested $176.3 million. The DOE appealed to the U.S. Court of Appeals for the Federal Circuit, which rendered an opinion generally supporting the Claims Court's decision and remanded the matter to it for further proceedings. In September, 2010, the Claims Court again awarded the companies an aggregate of approximately $143 million. The DOE again appealed and the Yankees cross-appealed. On May 18, 2012, the Court of Appeals again ruled in favor of the Yankees, awarding them an aggregate of approximately $160 million. The DOE sought reconsideration but, on September 5, 2012, the Court of Appeals for the Federal Circuit denied the petition for rehearing. The DOE elected not to file a petition for writ of certiorari seeking review by the U.S. Supreme Court and in January 2013 the awards were paid to the Yankees. As of March 2014, total net proceeds of $14.4 million have been refunded to NEP by Connecticut Yankee and Maine Yankee. Yankee Atomic did not provide a refund, but reduced monthly billing effective June 1, 2013.

On December 14, 2007, the Yankees brought further litigation in the Claims Court to recover subsequent damages incurred through 2008 (the "Phase II Litigation"). A Claims Court trial took place in October 2011. On November 1, 2013, the judge awarded the Yankees an aggregate of $235.4 million in damages for the Phase II Litigation. The DOE has elected not to seek appellate review. In March, 2014, Maine Yankee and Yankee Atomic received 100% of the DOE Phase II proceeds expected ($35.8 million and $73.3 million respectively). Connecticut Yankee received a partial payment of $90 million of the expected $126.3 million. The balance was received in April, 2014.

On April 29, 2014, the Yankees submitted informational filings to the FERC in order to flow through the DOE Phase II proceeds to their Sponsor companies, including NEP, in accordance with financial analyses that were performed earlier this year and supported by stakeholders from Connecticut, Massachusetts and Maine. The filings will allow for the flow through of the proceeds to the Sponsors, including NEP, with a proposed rate effective date of June 1, 2014. NEP's aggregate share will be approximately $58 million, which is recorded in accounts receivable in the accompanying consolidated balance sheets. NEP will refund its aggregate share to its customers through the CTCs.

On August 15, 2013 the Yankees brought further litigation in the Claims Court to recover damages incurred 2009 through 2012.

The U.S. Congress and the DOE have effectively terminated budgetary support for the proposed long-term spent fuel storage facility at Yucca Mountain in Nevada and the DOE took actions designed to prevent its construction. However, on August 12, 2013 the U.S. Court of Appeals for the District of Columbia Circuit directed the Nuclear Regulatory Commission ("NRC") to resume the Yucca Mountain licensing process despite insufficient funding to complete it. On October 28, 2013, the Circuit Court denied the NRC's petition for rehearing. On November 18, 2013, NRC ordered its staff to resume work on its Yucca Mountain safety report. A Blue Ribbon Commission ("BRC") charged with advising the DOE regarding alternatives to disposal at Yucca Mountain issued its final report on January 26, 2012. In the report, the BRC recommended that priority be given to removal of spent fuel from shutdown reactor sites. It is impossible to predict when the DOE will fulfill its obligation to take possession of the Yankees' spent fuel. The decommissioning costs that are actually incurred by the Yankees may substantially exceed the estimated amounts.

**Nuclear Contingencies**

As of March 31, 2014 and 2013, Niagara Mohawk had a liability of $168 million, recorded in other non-current liabilities in the accompanying consolidated balance sheets, for the disposal of nuclear fuel irradiated prior to 1983. The Nuclear Waste Policy Act of 1982 provides three payment options for liquidating such liability and Niagara Mohawk has elected to delay payment, with interest, until the year in which Constellation Energy Group Inc., which purchased Niagara Mohawk's nuclear assets, initially plans to ship irradiated fuel to an approved DOE disposal facility. Niagara Mohawk cannot predict the impact that the recent actions of the DOE and the U.S. government will have on the ability to dispose of the spent nuclear fuel and waste.

**Storm Costs Recovery**

In October 2012, SuperStorm Sandy hit the northeastern U.S. affecting energy supply to customers in the Company's service territory. Total costs associated with gas customer service restoration from this storm (including capital expenditures) were approximately $204.1 million through March 31, 2014, for the New York Gas Companies.

The Company has recorded an "other receivable" in the accompanying consolidated balance sheets in the amount of $58 million and $67 million as of March 31, 2014 and 2013, respectively, relating to claims filed against property damage and business interruption insurance policies, net of insurance deductibles and allowance. As of March 31, 2014, the Company has received $83.4 million from its insurers.

Total costs from SuperStorm Sandy associated with electricity customers' service restoration charged to LIPA through March 31, 2014, were approximately $668 million. The Company had outstanding accounts receivable from LIPA related to costs incurred in connection with SuperStorm Sandy of $88.4 million and $328.6 million at March 31, 2014 and 2013, respectively.

## 14. RELATED PARTY TRANSACTIONS

### Accounts Receivable from and Accounts Payable to Affiliates

The Company engages in various transactions with National Grid plc and its subsidiaries. Certain activities and costs, primarily executive and administrative and some human resources, legal, and strategic planning are shared between the Company and its affiliates.

The Company records short-term payables to and receivables from certain of its affiliates in the ordinary course of business. At March 31, 2014 and 2013, the Company had net outstanding accounts receivable from affiliates and accounts payable to affiliates balances as follows:

| | Accounts Receivable from Affiliates | | Accounts Payable to Affiliates | |
|---|---|---|---|---|
| | March 31, | | March 31, | |
| | **2014** | 2013 | **2014** | 2013 |
| | *(in millions of dollars)* | | *(in millions of dollars)* | |
| NGNA | **$ -** | $ - | **$ -** | $ 87 |
| National Grid plc | **-** | - | **60** | 36 |
| Other | **2** | 13 | **3** | - |
| Total | **$ 2** | $ 13 | **$ 63** | $ 123 |

### Advances from Affiliates

In August 2009, the Company and KeySpan Corporation entered into an agreement with the Parent, whereby either party can collectively borrow up to $3 billion from time to time for working capital needs. These advances bear interest rates of London Interbank Offered Rate plus 1.4%. At March 31, 2014 and 2013, the Company had $750 million and zero outstanding under this agreement.

In August 2008, the Company entered into an agreement with NGNA, whereby the Company can borrow up to $1.5 billion from time to time for working capital needs. These advances do not bear interest. At March 31, 2014 and 2013, the Company had $1.4 billion and zero outstanding advances from NGNA under this agreement.

### Holding Company Charges

The Company received charges from National Grid Commercial Holdings Limited (an affiliated company in the U.K.) for certain corporate and administrative services provided by the corporate functions of National Grid plc to its U.S. subsidiaries. For the years ended March 31, 2014 and 2013, the effect on net income was $52 million before tax and $34 million after tax.

## 15. PREFERRED STOCK

### Preferred stock of NGUSA subsidiaries

The Company's subsidiaries have certain issues of non-participating preferred stock, some of which provide for redemption at the option of the Company. A summary of the preferred stock of NGUSA subsidiaries at March 31, 2014 and 2013 is as follows:

| | | Shares Outstanding | | Amount | | |
|---|---|---|---|---|---|---|
| | | March 31, | | March 31, | | Call |
| Series | Company | **2014** | 2013 | **2014** | 2013 | Price |
| | | *(in millions of dollars, except per share and number of shares data)* | | | | |
| $100 par value - | | | | | | |
| 3.40% Series | Niagara Mohawk | **57,524** | 57,524 | **$ 6** | $ 6 | $ 103.500 |
| 3.60% Series | Niagara Mohawk | **137,152** | 137,152 | **14** | 14 | 104.850 |
| 3.90% Series | Niagara Mohawk | **95,171** | 95,171 | **9** | 9 | 106.000 |
| 4.44% Series | Massachusetts Electric | **22,585** | 22,585 | **2** | 2 | 104.068 |
| 6.00% Series | NEP | **11,117** | 11,117 | **1** | 1 | Non-callable |
| $50 par value - | | | | | | |
| 4.50% Series | Narragansett | **49,089** | 49,089 | **3** | 3 | 55.000 |
| Golden Shares - | | | | | | |
| | Niagara Mohawk and KeySpan subsidiaries | **3** | 3 | **-** | - | Non-callable |
| Total | | **372,641** | 372,641 | **$ 35** | $ 35 | |

In connection with the acquisition of KeySpan by NGUSA, each of the Company's New York subsidiaries became subject to a requirement to issue a class of preferred stock having one share (the "Golden Share"), subordinate to any existing preferred stock. The holder of the Golden Share would have voting rights that limit the Company's right to commence any voluntary bankruptcy, liquidation, receivership or similar proceeding without the consent of the holder of the Golden Share. The NYPSC subsequently authorized the issuance of the Golden Share to a trustee, GSS Holdings, Inc. ("GSS"), who will hold the Golden Share subject to a Services and Indemnity Agreement requiring GSS to vote the Golden Share in the best interests of New York State. On July 8, 2011, the Company issued a total of 3 Golden Shares pertaining to Niagara Mohawk, Brooklyn Union, and KeySpan Gas East each with a par value of $1.

### Preferred stock of NGUSA

The Company has series A through F non-participating non-callable preferred stock (5,000 total shares authorized, 915 outstanding) which have no fixed redemption date. The series A through F shares rank above all common shares, but below the Company's debt holders in an event of liquidation. If the Company does not pay its annual dividend on the A through F series preferred stock, it is subject to limitations on the payment of any dividends to its common shareholder. The par value of the series A through F preferred stock is $0.10. The fixed rate on the series A through E preferred stock is 6.5%. The fixed rate on the series F preferred stock is 8.5%.

In August 2012, by written consent of the Company's shareholders, the annual dividend payment date on the series A through E preferred stock was changed from September 30 to August 24. As a result, the amount of the preferred stock dividend for the series A through E preferred stock was adjusted during the year ended March 31, 2013.

A summary of preferred stock is as follows:

| | Shares Outstanding | | Amount (par) | | Amount (additional paid-in capital) | |
|---|---|---|---|---|---|---|
| | March 31, | | March 31, | | March 31, | |
| Series | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 |
| | *(in millions of dollars, except per share and number of shares data)* | | | | | |
| $0.10 par value - | | | | | | |
| Series A | **51** | 51 | **$ -** | $ - | **$ 400** | $ 400 |
| Series B | **40** | 40 | **-** | - | **315** | 315 |
| Series C | **96** | 96 | **-** | - | **750** | 750 |
| Series D | **79** | 79 | **-** | - | **616** | 616 |
| Series E | **1** | 1 | **-** | - | **10** | 10 |
| Series F | **648** | 648 | **-** | - | **5,368** | 5,368 |
| Total | **915** | 915 | **$ -** | $ - | **$ 7,459** | $ 7,459 |

## 16. STOCK-BASED COMPENSATION

The Parent's Remuneration Committee determines remuneration policy and practices with the aim of attracting, motivating and retaining high caliber Executive Directors and other senior employees to deliver value for shareholders, high levels of customer service, and safety and reliability in an efficient and responsible manner. As such, the Remuneration Committee has established a Long-Term Performance Plan ("LTPP") which aims to drive long-term performance, aligning Executive Director incentives to shareholder interests. The LTPP replaces the previous Performance Share Plan ("PSP") which operated for awards between 2003 and 2010 inclusive. Both plans issue performance based restricted stock units ("RSU"s) which are granted in the Parent's common stock traded on the London Stock Exchange for U.K.-based directors and employees or the Parent's American Depository Receipts traded on the New York Stock Exchange for U.S.-based directors and employees. Both plans have a performance period of three years and have been approved by the Parent's Remuneration Committee.

As of March 31, 2014, the Parent had 3.9 billion of ordinary shares issued with 123,948,354 held as treasury shares. The aggregate dilution resulting from executive share-based incentives will not exceed 5% in any 10-year period for executive share-based incentives and will not exceed 10% in any 10-year period for all employee incentives. This is reviewed by the Remuneration Committee and currently, the Parent has excess headroom of 4.10% and 7.99% respectively.

The number of units within each award is subject to change depending upon the Parent's ability to meet the stated performance targets. Under the LTPP, performance conditions are split into three parts as follows: (i) 50% of the units awarded are subject to annualized growth in the Parent's earnings per share ("EPS") over a general index of retail prices over a period of three years; (2) 25% of the units awarded will vest based upon the Parent's Total Shareholder Return ("TSR") compared to that of the Financial Times Stock Exchange ("FTSE") 100 over a period of three years; and (3) 25% of the units awarded are subject to the average achieved regulatory ROE. Under the PSP, performance conditions are split into two parts as follows: (1) 50% of the units awarded are subject to annualized growth in the Parent's EPS over a general index of retail prices over a period of three years; and (2) 50% of the units awarded will vest based upon the Parent's TSR compared to that of the FTSE 100 over a period of three years. Units under both plans generally vest at the end of the performance period.

A Monte Carlo simulation model has been used to estimate the fair value for the TSR portion of the awards. For the EPS and ROE portions of the awards, the fair value of the award is determined using the stock price as quoted per the London Stock Exchange or the price for the American Depository Shares as quoted on the New York Stock Exchange as of the earlier of the reporting date or vesting date.

The following assumptions were used to calculate the fair value of the TSR portion of the awards issued during the fiscal year ended March 31, 2014:

| | **2014** | 2013 |
|---|---|---|
| Expected volatility | **18.39%** | 12.72% - 14.48% |
| Expected term | **3 years** | 3 years |
| Risk free rates | **0.66%** | 0.07% - 0.26% |

The EPS portions of the awards are classified as liability awards as they are each indexed to a factor that is not a market, performance, or service condition. Therefore, the changes in the fair value of the EPS portions of the awards are reflected within net income. The TSR and ROE portions of the awards are classified as equity awards as they are indexed to market conditions and are expensed over the performance period.

The following table summarizes the stock based compensation expense recognized by the Company for the years ended March 31, 2014 and 2013:

| | **Units** | **Weighted Average Grant Date Fair Value** |
|---|---|---|
| **Non-vested as of March 31, 2012** | 1,015,540 | $ 42.19 |
| Vested | 119,468 | 45.53 |
| Granted | 272,274 | 48.29 |
| Forfeited/Cancelled | 222,401 | 42.97 |
| **Non-vested as of March 31, 2013** | 945,945 | 40.36 |
| Vested | 183,275 | 46.37 |
| Granted | 247,891 | 55.96 |
| Forfeited/Cancelled | 89,829 | 49.00 |
| **Non-vested as of March 31, 2014** | 920,732 | $ 49.92 |

The total expense recognized for non-vested awards was $19.0 million and $24.7 million for the years ended March 31, 2014 and 2013 respectively, and will vest over three years. The total tax benefit recorded was approximately $7.6 million and $9.9 million as of March 31, 2014 and 2013 respectively. Total expense expected to be recognized by the Parent in future periods for non-vested awards outstanding as of March 31, 2014 is $9.0 million, $4.7 million, and $1.4 million for the years ended March 31, 2015, 2016, and 2017 respectively.

## 17. DISCONTINUED OPERATIONS

On December 8, 2010, the Company and Liberty Energy entered into a stock purchase agreement which was subsequently amended and restated on January 21, 2011, pursuant to which the Company sold and Liberty Energy purchased all of the common stock of Granite State and EnergyNorth. The parties received FERC approval in July 2011 and New Hampshire Public Utilities Commission approval in May 2012. Granite State and EnergyNorth were sold on July 3, 2012 for proceeds of $294 million. The results of Granite State and EnergyNorth are reflected as discontinued operations in the accompanying consolidated statements of income for the year ended March 31, 2013.

On December 15, 2011, LIPA announced that it was not renewing the MSA contract beyond its expiration on December 31, 2013. During the year ended March 31, 2013, the MSA contract represented approximately 9.9% of the Company's annual revenue and 1.2% of its operating income. In addition, the loss of the contract resulted in 1,950 employees transferring to a new employer. The results of the MSA are reflected as discontinued operations in the accompanying consolidated financial statements for the years ended March 31, 2014 and 2013.

Following the expiration of the MSA, the Company entered into a Settlement and Release Agreement ("SRA") with LIPA. Under the terms of this SRA, LIPA (1) fully released the Company from its obligations under certain promissory notes payable to LIPA, and (2) agreed to make a one-time lump sum payment to the Company of $91.5 million. In return, the Company fully released LIPA from certain claims for reimbursement of pension and PBOP costs. As a result, the Company recorded a gain of approximately $231.0 million, primarily related to the extinguishment of debt and recognition of a receivable for the lump sum cash payment (which was received from LIPA in April 2014).

In addition, a $97.0 million net settlement gain and a $43.0 million net curtailment gain were recognized for the employees who transferred to a new employer. The new employer had assumed responsibility for the transferred employees' obligations under the PBOP.

The reconciliation below highlights the major classes of line items constituting income before income taxes of discontinued operations for Granite State, EnergyNorth and the MSA for the years ended March 31, 2014 and 2013:

| | Years Ended March 31, | |
|---|---|---|
| | **2014** | 2013 |
| | *(in millions of dollars)* | |
| **Major classes of line items constituting income before income taxes of discontinued operations** | | |
| Revenue | **$ 476** | $ 1,288 |
| Purchased electricity | **-** | (8) |
| Purchased gas | | (8) |
| Operations and maintenance | **(601)** | (1,267) |
| Other expenses | **(19)** | (12) |
| Loss before income taxes from discontinued operations | **(144)** | (7) |
| Gain (loss) on disposal of discontinued operations | **371** | (34) |
| Total income (loss) before income taxes from discontinued operations | **227** | (41) |
| Income tax expense (benefit) | **94** | (27) |
| **Income (loss) from discontinued operations, net of taxes** | **$ 133** | $ (14) |

The reconciliation below highlights the carrying values of assets and liabilities of the discontinued operations that are disclosed in the accompanying consolidated balance sheets for the MSA at March 31, 2014 and 2013:

| | March 31, | |
|---|---|---|
| | **2014** | 2013 |
| | *(in millions of dollars)* | |
| **Carrying values of assets included in the discontinued operations:** | | |
| Cash and cash equivalents | **$ -** | $ 1 |
| Accounts receivable | **219** | 96 |
| Allowance for doubtful accounts | **(70)** | (33) |
| Unbilled revenues | **2** | 336 |
| Inventory | **-** | 16 |
| Property, plant, and equipment, net | **-** | 28 |
| Deferred income tax assets | **29** | 9 |
| Other assets that are not major | **2** | 26 |
| Total assets classified as discontinued operations in the consolidated balance sheets | **$ 182** | $ 479 |
| **Carrying values of liabilities included in the discontinued operations:** | | |
| Accounts payable | **$ 20** | $ 146 |
| Taxes accrued | **2** | 5 |
| Long-term debt | **-** | 155 |
| Other liabilities that are not major | **15** | 22 |
| Total liabilties classified as discontinued operations in the consolidated balance sheets | **$ 37** | $ 328 |

## 18. SUBSEQUENT EVENTS

In September 2014, Niagara Mohawk issued $500 million of unsecured long-term debt at 3.508% with a maturity date of October 1, 2024 and $400 million of unsecured long-term debt at 4.278% with a maturity date of October 1, 2034.

Financial Statements for Clean Line Energy Partners LLC and Plains and Eastern Clean Line Holdings LLC are attached as Confidential Appendix 6-E