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National Grid Gas plc
Annual Report and Accounts 2017/18

Company number 2006000

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National Grid Gas plc Annual Report and Accounts 2017/18

Overview

About National Grid Gas plc

National Grid Gas plc (National Grid Gas) is a subsidiary of National Grid plc (National Grid), based in the UK. We own and operate the regulated gas National Transmission System (NTS) in Great Britain, with day-to-day responsibility for balancing supply and demand, and provide gas metering services. We play a vital role in connecting millions of people safely, reliably and efficiently to the energy they use.

The overall management and governance of National Grid Gas is the responsibility of its Board of Directors. Strategic direction is determined by our ultimate parent company, National Grid. Our Directors are listed on page 31.

More information on the management structure of National Grid can be found in the National Grid plc Annual Report and Accounts 2017/18 and on National Grid's website at www.nationalgrid.com.

Financial highlights

	2017/18* £m	2016/17* £m	Percentage change
Operating profit	647	464	39%
Adjusted operating profit[1]	647	573	13%
Cash generated from operations	956	723	32%
Regulated assets[2]	6,014	5,755	5%

1. See page 21 for further details
2. See page 24 for further details.

	2017/18* £m	2016/17* £m
Return on equity: Gas Transmission	10.0%	10.8%

Non-financial highlights

	2017/18*	2016/17*
Number of employees	2,134	1,925
Network reliability: Gas Transmission	99.996151%	99.975000%

* Represents continuing operations only

What we do - Gas

The gas industry connects producers, processors, storage and transmission and distribution network operators, as well as suppliers to industrial, commercial and domestic users.

The UK gas industry has four main sectors.

1. Production and importation

There are seven gas reception terminals, three Liquefied Natural Gas (LNG) importation terminals and three interconnectors connecting Great Britain (GB) via undersea pipes with Ireland, Belgium and the Netherlands. Importers bring LNG from the Middle East, the Americas and other places.

We do not produce gas. Gas used is mainly sourced from gas fields in the North and Irish seas, piped from Europe and imported as LNG.

2. Transmission

The transmission system includes pipes and compressor stations. They connect production and storage through terminals to the distribution systems.

Gas enters the transmission system through importation and reception terminals and interconnectors and may include gas previously held in storage. Compressor stations located along the network play a vital role in keeping large quantities of gas flowing through the system, particularly at times of high demand.

The gas transmission system has to be kept constantly in balance, which is achieved by buying, selling and using stored gas. This means that, under normal circumstances, demand can be met. We are the sole owner and operator of gas transmission infrastructure in Great Britain.

3. Distribution

Gas leaves the transmission system and enters the distribution networks at high pressure. It is then transported through a number of reducing pressure tiers until it is finally delivered to consumers.

There are eight regional gas distribution networks in the UK, none of which we own.

On 1 October 2016 National Grid Gas plc sold its Gas Distribution business and associated assets to National Grid Gas Distribution Limited, a fellow National Grid plc group undertaking.

4. Supply

Pipeline shippers bring gas from producers to suppliers, who in turn sell it to customers.

We do not supply gas, however we own National Grid Metering Ltd, which provides meters and metering services to supply companies, under contract.

Customers pay the supplier for the cost of gas and for its transportation. We transport the gas through our network on behalf of shippers, who pay us transportation charges.

What we do – Regulation

Our business operates as a regulated monopoly. We have one economic regulator for our business, Office of Gas and Electricity Markets (Ofgem). The regulator safeguards customers' interests by setting the level of revenues we are allowed to recover, ensuring we provide value for money while maintaining safe and reliable networks, and deliver good customer service.

How we make money from our regulated assets
Our licence, established under the Gas Act 1986, as amended (the Act) requires us to develop, maintain and operate economic and efficient networks and to facilitate competition in the supply of gas in Great Britain. It also gives us statutory powers. These include the right to bury our pipes under public highways and the ability to use compulsory powers to purchase land so we can conduct our business.

Our network is regulated by Ofgem, which has established price control mechanisms that set the amount of revenue our regulated businesses can earn. Price control regulation is designed to make sure our interests, as a monopoly, are balanced with those of our customers. Ofgem allows us to charge reasonable, but not excessive, prices. This gives us a future level of revenue that is sufficient to meet our statutory duties and licence obligations, and make a reasonable return on our investment.

The price control includes a number of mechanisms designed to help achieve its objectives. These include financial incentives that encourage us to:

- efficiently deliver by investing and maintaining the network outputs that customers and stakeholders require, including reliable supplies, new connections and infrastructure capacity;
- innovate in order to continuously improve the services we give our customers, stakeholders and communities; and
- efficiently balance the transmission networks to support the wholesale markets.

The Gas Transmission (GT) business operates under two separate price controls; one as transmission owner (TO) and one as system operator (SO). In addition to the two regulated network price controls, there is also a tariff cap price control applied to certain elements of domestic sized metering and daily meter reading activities carried out by National Grid Metering.

RIIO Price Controls
The building blocks of the RIIO price control are broadly similar to the historical price controls used in the UK. However, there are some significant differences in the mechanics of the calculations.

How is revenue calculated?

Outputs
Under RIIO the outputs we deliver are clearly articulated and are integrally linked to the calculation of our allowed revenue. These outputs have been determined through an extensive consultation process, which has given stakeholders a greater opportunity to influence the decisions.

The five output categories are:

Safety - ensuring the provision of a safe energy network.

Reliability (and availability) - promoting networks capable of delivering long-term reliability, as well as minimising the number and duration of interruptions experienced over the price control period, and ensuring adaptation to climate change.

Environmental impact - encouraging companies to play their role in achieving broader environmental objectives, specifically, facilitating the reduction of carbon emissions, as well as minimising their own carbon footprint.

Customer and stakeholder satisfaction - maintaining high levels of customer satisfaction and stakeholder engagement, and improving service levels.

Customer connections - encouraging networks to connect customers quickly and efficiently.

Within each of these output categories are a number of primary and secondary deliverables, reflecting what our stakeholders want us to deliver over the remaining price control period. The nature and number of these deliverables varies according to the output category, with some being linked directly to our allowed revenue, some linked to legislation, and others having only a reputational impact.

Totex
Ofgem, using information we have submitted, along with independent assessments, determines the efficient level of expected costs necessary to deliver our outputs. Under RIIO this is known as totex, which is our total allowable expenditure, and is the sum of what was defined in previous price controls as operating expenditure (opex) and capital expenditure (capex).

A number of assumptions are necessary in setting allowances for these outputs, including the volumes of work that will be needed and the price of the various external inputs to achieve them. Consequently, there are a number of uncertainty mechanisms within the RIIO framework that can result in adjustments to totex allowances if work volumes differ from the assumptions. These mechanisms protect us and our customers from windfall gains and losses.

Where we under- or over-spend the allowed totex for reasons that are not covered by uncertainty mechanisms, there is a sharing factor. This means the under- or over-spend is shared between us and customers through an adjustment to allowed revenues in future years. This sharing factor provides an incentive for us to provide the outputs efficiently, as we are able to keep a portion of savings we make, with the remainder benefiting our customers.

The extended length of the price control to eight years is one of the ways that RIIO has given innovation more prominence. Innovation refers to all the new ways of working that deliver outputs more efficiently. This broad challenge has an impact on everyone in our business.

Allowed revenue to fund totex costs is split between 'fast' and 'slow' money categories using specified ratios that are fixed for the duration of the price control. Fast money represents the amount of totex we are able to recover in the next available year. Slow money is added to our Regulated Asset Value (RAV) – effectively the regulatory IOU. For more details on the sharing factors under RIIO, please see the sharing factors and fast money section.

In addition to fast money, we are allowed to recover a portion of the RAV (regulatory depreciation) and a return on the outstanding RAV balance each year. Regulatory depreciation permits recovery of RAV consistent with each addition bringing equal real benefit to consumers for a period of up to 45 years. We are also allowed to collect additional revenues related to non-controllable costs and incentives. In addition to totex sharing, RIIO incentive mechanisms can increase or decrease our allowed revenue to reflect our performance against various other measures related to our outputs. For example, performance against our customer and stakeholder satisfaction targets can have a positive or negative effect of up to 1% of allowed annual revenues. Most of our incentives affect our revenues two years after the year of performance.

During the eight-year period of the price control our regulator included a provision for a mid-period review, with scope driven by:

- changes to outputs that can be justified by clear changes in government policy; and
- the introduction of new outputs that are needed to meet the needs of consumers and other network users.

The mid-period review of the gas transmission control focused on a removal of the need for the Avonmouth pipeline and associated reduction in allowances of £168.8 million (in 2009/2010 prices).

Ofgem also separately reviewed the obligation to provide additional gas entry capacity at Fleetwood. It concluded that this additional capacity was not required, so no incremental revenues would be payable. National Grid Gas had incurred no incremental costs in anticipation of this obligation.

Allowed returns

The cost of capital allowed under RIIO is as follows:

	Gas Transmission
Cost of equity (post-tax real)	6.8%
Cost of debt (pre-tax real)	iBoxx 10-year simple trailing average index (2.22% for 2017/18)
Notional gearing	62.5%
Vanilla WACC	3.94%

**Vanilla WACC = cost of debt x gearing + cost of equity x (1- gearing)*

Sharing factors and fast money

The sharing factor means that any over- and under-spend is shared between the businesses and consumers.

Sharing factors applicable to GT under RIIO are as follows:

Gas Transmission	Transmission Operator	System Operator
Fast[1]	Baseline[3] 35.6%, Uncertainty 10%	62.60%
Slow[2]	Baseline[3] 64.4%, Uncertainty 90%	37.40%
Sharing[4]		44.36%

[1] *Fast money allows network companies to recover a percentage of total expenditure within a one year period.*
[2] *Slow money is where costs are added to RAV and, therefore, revenues are recovered slowly (e.g. over 45 years) from both current and future consumers.*
[3] *The Baseline is the expenditure funded through ex ante allowances, whereas the uncertainty adjusts the allowed expenditure where the level outputs delivered differ from the baseline level, or if triggered by an event.*
[4] *The sharing factor is the proportion of over and under spend retained by National Grid Gas.*

For more information on RIIO, including incentive mechanisms, please see the relevant investor fact sheets on the Investor Relations section of the National Grid website, www.nationalgrid.com.

Principal Operations - Gas Transmission

What we do

We own and operate the regulated gas national transmission system, with day-to-day responsibility for balancing supply and demand. We play a pivotal role in connecting millions of people safely, reliably and efficiently to the energy they use. Our network comprises approximately 4,760 miles of high-pressure pipe and 618 above-ground installations.

Market Context

The UK's gas market and sources of gas are changing. The UK now obtains less than half of it's gas from the North Sea (or UK Continental Shelf - UKCS). The UK receives gas from Norway, continental Europe and further afield via LNG shipments into three import terminals around the country.

Overall, supply capacity now exceeds peak demand by more than 30%, giving our customers significant flexibility over which sources of gas they choose to meet demand. Flexible sources of supply, such as LNG importation terminals, interconnectors and storage sites, can respond to demand more quickly than traditional UKCS supplies. Therefore, our network needs to be able to respond to changing day-to-day and within-day supply and demand patterns.

We also need to prepare for an uncertain energy landscape in the long term. UK reliance on imported gas supplies will vary depending on the level of gas supply from the UKCS and the development of indigenous gas sources.

We are working closely with our customers and stakeholders to meet these operational challenges. We are focused on continuing to develop our network and services to meet their needs safely, reliably and efficiently.

Operational Performance

For the full year 2017/18 our employee lost time injury frequency rate was 0.05 which is consistent with world-class safety performance. Over the year we performed significantly better than our high potential incidents target, which tracks the events with the potential to cause more serious harm. We have also worked hard on risk assessments both ahead of work and at the point of work across our business.

As well as continued focus on safety, we are constantly looking for other ways to optimise our operational performance. We met our customer satisfaction target for 2017/18. The score for Gas Transmission was 7.62. This exceeds our agreed target of 6.90.

We have also made positive progress in our first year using Net Promoter Score. We are gaining more insight into the needs of our customers (and theirs). For example, the need for greater transparency has been a continuing theme.

To improve transparency we have a new online customer connections platform, which is in the testing phase. We are working with customers to identify a suitable pilot opportunity.

We have continued to provide reliable services. We report on our key performance indicators in detail on page 9. This year our network reliability score for Gas Transmission was 99.996151%.

We have updated many of our back-office systems to improve data and management control. We have made substantial progress in our asset health data collection efforts and we have prioritised spend over the remainder of this regulatory control period.

Our business has made good progress on Project GRAID (Gas Robotic Agile Inspection Device), which is developing an innovative robotic inspection device for underground pipework. This year we have developed the robot for offline trials ahead of live site trials later in 2018. To continue to provide low-cost services which our customers want, we know we must innovate.

In late February, adverse weather affected the UK, leading to high demand for energy on the system. Our networks performed strongly, maintaining secure supplies of gas. As part of our response we issued a Gas Deficit Warning. This signalled to the market that we required more gas to keep the system running safely and reliably. This is part of our standard approach to balancing supply and demand, and worked effectively.

Looking ahead

The current price controls are set to run for an eight-year period and will end on 31 March 2021. Ahead of the new regulatory framework (RIIO T2) we will continue to engage with stakeholders and work with Ofgem to clarify the parameters of RIIO T2. We have mobilised teams to prepare for RIIO T2 drawing on the depth of knowledge across our business. In depth stakeholder engagement has commenced and will continue throughout the process. National Grid has responded to the RIIO T2 Framework Consultation document issued by Ofgem in March 2018 and we expect the framework to be finalised during the summer of 2018 with Ofgem publishing their final view on the final price control allowances by the end of 2020.

Next year we will continue to focus on safe, customer-led, and innovative operations. Achieving greater efficiency in our businesses will be a priority for us – particularly important considering the price cap for supply to consumers that the Government is seeking to impose.

Principal Operations - System Operator

As Great Britain's System Operator (SO) we make sure supply and demand are balanced in real-time and we facilitate the connection of assets to the transmission system.

Market context
Sources of energy are changing. The changing location of gas being input into the transmission system will drive greater need for flexibility as the traditional north-south flow diminishes and as new forms of low carbon gases are considered to support the transition to a low carbon future.

This makes our role in matching supply and demand more challenging, so we work with the market to make sure we have appropriate tools in place to balance the transmission system. We work with our customers and stakeholders to shape the future of the energy market, providing analysis and insight into the changing nature of energy and the role that gas and decarbonising gas can play to support national climate ambitions. We also facilitate changes to the market frameworks to accommodate new technologies and ways of working, while considering how the role of the SO should evolve over time, in a future that could see different forms of low carbon gas, such as hydrogen, biogas and bioSNG, alongside natural gas.

The SO is at the forefront of this debate helping to find solutions with industry and decision makers.

Operational Performance
We continue to play a leading role in helping develop the UK's future energy strategy, and that of Europe. Our approach includes working with customers and stakeholders on initiatives such as the translation of new EU code requirements for gas, the development of new demand side services supporting the harmonisation of gas trading arrangements across Europe, our Future Energy Scenarios reports, our Future of Gas programme and System Operability Framework workshops and webinars.

We are working hard across our business to place customers at the heart of our operations. We're holding workshops for customers so we can gain a more in-depth understanding of their requirements, not just today, but potential needs in the coming decades as a result of the low carbon transition, which could see hydrogen and biofuels used alongside natural gas. We have also started to examine each point of contact they have with our Company, so we can identify where we can improve our processes and our customers' experience with us. We will be testing proposed improvements with customers before we implement them.

Priorities for the year ahead
We will continue to find better ways to provide timely, cost effective and innovative solutions to balance supply and demand for gas.

Market developments
We will continue to work with Ofgem and The Department for Business Energy and Industrial Strategy (BEIS) as they develop proposals to help meet the energy and decarbonisation challenges of the future, so gas and decarbonised gas can support clean growth in the UK.

Customers and stakeholders
We will continue to develop our longer-term strategy to understand the issues that will affect our customers and stakeholders in the future, and plan how we will best support them building on work from our Future of Gas programme.

Delivering energy
We will continue to support the evolution of market frameworks in the UK and Europe to enable new types of production and importation, also for demand to come forward in response as the energy landscape evolves.

Principal Operations – Other activities

Other activities include National Grid Metering and other corporate activities.

National Grid Metering
National Grid Metering (NGM) provides installation and maintenance services to energy suppliers in the regulated market in Great Britain. It maintains an asset base of over 12 million domestic, industrial and commercial meters.

Customer satisfaction scores for NGM remain positive for domestic, industrial and commercial businesses. We continue to work with our customers on areas for improvement by exploring additional products and services so we can respond to the rapidly changing non-domestic sector.

Our purpose, vision, strategy and values

We work within the purpose, vision, strategy and values of the National Grid Group to ensure we are well positioned to respond to changes in the operating environment.

Our purpose

Having a clear sense of what we stand for as a company and what it is that binds us all together is vitally important. This is what we call our purpose. In simple terms it's what drives our desire to serve our customers and makes us proud about the work we do.

Our purpose is to bring energy to life

Essentially, 'Bring Energy to Life' means getting the heat, light and power that customers rely on to their homes and businesses. But 'Life' also means supporting the communities that we are a part of and live among to support the economic growth and sustainability of wider society.

Our vision

We will exceed the expectations of our customers, shareholders and communities today and make possible the energy systems of tomorrow.

Our vision describes how we create value – not just today, but in the future too.

The needs of our customers, shareholders and communities are at the heart of everything we do. So, our vision statement clearly describes the ambitious challenge we have set ourselves – to make sure we deliver value for them every day.

Our vision also looks to the future, reminding us of the critical role we will play for future generations. We continue to see changes in our energy system as more renewable and decentralised generation is introduced. To be relevant in this future, we have to play an active role in helping shape the energy landscape, and benefiting from what it provides.

Our strategy

We are focussed on three strategic priorities for our business, which will set the foundations for our future success. These are described below.

1) Find new ways of optimising our operational performance
We will exceed the expectations of our customers, shareholders and communities today and make possible the energy systems of tomorrow.

Our customers want and need us to be more efficient, so we must find ways to improve how we run our business. We have looked at enhancing our productivity and customer experience through more efficient and customer-focused processes. Given the scale of our core business, even small improvements will have a huge impact on our overall performance. Finding new ways of optimising our operational performance will be an important factor in our ability to compete and grow. It creates the financial capacity and the capability for us to future-proof our business.

2) Look for opportunities to grow our core business
Delivering strong operational performance provides us with a foundation to pursue other opportunities. We will continue to pursue business development opportunities that are close to our core business. In the UK competitive onshore transmission projects will continue to be our focus over the next decade.

3) Make sure National Grid is better equipped for the future
We need to future-proof our business against the effects of a changing energy landscape. The operation of our networks is already affected by changes to the generation mix, while the needs and expectations of our customers are evolving.

Our values

Every day we do the right thing and will find a better way.

We know that how we deliver is as important as what we deliver. If our purpose is the 'why', our values are the 'how'. They help shape our spirit, attitude and what guides us. We have to adapt and develop our values to align with the expectations of our customers and communities, without losing sight of the things that make us strong today.

Our values build on and protect our strong foundations while looking to the future. They are aligned to our purpose and help our people understand how we expect to achieve our purpose and vision for our customers and each other.

'Do the right thing' pulls together our foundational values – keeping each other and the public safe; complying with all the relevant rules, regulations and policies; respecting our colleagues, customers and communities; and saying what we think and challenging constructively. 'Find a better way' challenges us to focus on performance and continuous improvement for our customers, our shareholders and communities.

Our strategic objectives

We are focused on three strategic priorities for our business, which will set the foundations for our future success. These are described below;

	Find new ways of optimising our operational performance	Look for opportunities to grow our core business	Make sure National Grid is better equipped for the future
Why it's important	Our customers want and need us to be more efficient, so we must find ways to improve how we run our business.	To make possible the energy systems of tomorrow requires investment in our core and many areas close to our core.	We need to future-proof our business against the effects of a changing energy landscape. The operation of our networks is already affected by changes, while the needs and expectations of our customers are evolving.
What this means	We have looked at enhancing our productivity and customer experience through more efficient and customer-focused processes. Finding new ways of optimising our operational performance will be an important factor in our ability to compete and grow. It creates the financial capacity and the capability for us to future-proof our business.	We continue to pursue business development opportunities that are close to our core business.	We are looking to develop new capabilities that are essential for long-term success.
How we measure ourselves	• Safety performance • Customer satisfaction scores • Network reliability • Greenhouse gas emissions reduction	• Regulated asset base growth • Capital investment	• Innovation investment • Skills and capabilities
	The metrics below underpin all our strategic priorities: Employee engagement; Workforce diversity		

Progress against objectives - key performance indicators (KPIs)

Strategic objective	KPI and definition	Performance
Find new ways of optimising our operational performance	**Safety – Employee lost time frequency rate (IFR)** Injuries resulting in employees taking time off work per 100,000 hours worked on a 12 month basis.	**2017/18: 0.05 (Target 0.1)** 2016/17: 0.11 (Target 0.1)
	Network reliability Reliability of gas network as a percentage against the target set by Ofgem.	**2017/18: 99.996151% (Target 100%)** 2016/17: 99.97500% (Target 100%)
	Customer satisfaction scores Our score in customer satisfaction surveys. Ofgem set a baseline.	**2017/18: 7.62 out of 10 (Target 6.9)** 2016/17: 8.0 out of 10 (Target 6.9) Figures represent our baseline targets set by Ofgem for reward or penalty under RIIO.
	Greenhouse gas emissions Percentage reduction in greenhouse gas emissions. National Grid target 2017/18 and 2016/17: 45% reduction by 2020 and 80% reduction by 2050, compared to 1990 baseline emissions.	**Tonnes carbon dioxide** **2017/18: 672 KTCO2e** 2016/17: 670 KTCO2e National Grid plc Group has achieved a 65% reduction against the 1990 baseline to date.
Look for opportunities to grow our core business	**Regulated asset base growth** Maintaining efficient growth in the total Regulated Asset Value (RAV) base.	**2017/18: 4.5%** 2016/17: 3.0%
	Capital investment Additions to Property, Plant and Equipment and Intangible Assets.	**2017/18: £340 million** 2016/17: £526 million
Make sure National Grid is better equipped for the future	**Innovation investment** We are in the midst of an energy revolution with the economic landscape, developments in technology, evolving business models and consumer behaviours all changing at an unprecedented rate. We are focussing our innovation on four value themes: **Manging assets** – look for innovative ways to manage asset life **Efficient build** – finding ways to reduce the cost of building new infrastructure **Service delivery** – we're exploring ways to provide value to our customers **Corporate responsibility** – we're constantly researching and developing safer working practices.	
	Skills and capabilities We measure quality (>1 hour) interactions with young people on STEM subjects. We support developing the skills and capabilities of young people through skills-sharing employee volunteering, especially in STEM subjects. While we have no specific target, our aim is to encourage many young people to get involved in STEM subjects.	**Number of quality interactions** **2017/18: 35,425** 2016/17: 29,591 Figures represent performance for National Grid plc
Underpin all three strategic priorities	**Employee engagement index** Employee engagement index calculated using responses to National Grid's annual employee survey. Target is to increase the level of engagement compared with previous year. See pages 12 and 13 for the actions we are taking.	**2017/18: 72%** 2016/17: 78% Index represents performance for National Grid UK entities
	Workforce diversity We measure the percentage of women and ethnic minorities in our workforce. We aim to develop and operate a business that has an inclusive and diverse culture. See pages 12 and 13 for the actions we are taking.	**Workforce diversity %** **2017/18: Women: 34.3%** **Ethnic minority: 12.0%** 2016/17: Women: 33.7% Ethnic minority 9.3%

Greenhouse gas emissions

National Grid has remained focused on greenhouse gas emissions reduction programmes to achieve the corporate commitment targets of 45% and 80% reduction in Scope 1 and 2 emissions by 2020 and 2050 respectively from the 1990 baseline. National Grid continues to look for innovations and efficiencies that will help us achieve targets.

National Grid measure and report in accordance with the World Resources Institute and World Business Council on Sustainable Development Greenhouse Gas Protocol: Corporate Accounting and Reporting Standard (Revised Edition) for all six Kyoto gases, using the operational approach for emissions accounting. 100% of National Grid plc's Scope 1 and 2 emissions and 92% of Scope 3 emissions are independently assured against ISO 14064-3 Greenhouse Gas assurance protocol.A copy of this statement of assurance is available on the National Grid website. See the National Grid plc 2017/18 Annual Report and Accounts for further information.

Strategic Report

Operating environment

Our environment is shaped by four themes. The first three are distinct objectives that need to be met in providing energy to customers, but which are often in tension. Choices that governments make in seeking to appropriately balance these objectives can result in regulatory changes. The final theme is technology, which is shaping the way we respond and transform our operations for the better.

Impact on consumer bills

Commentary
Consumers expect a reliable energy system that delivers gas when and where it is needed. They pay for the cost of this infrastructure and improvements to it through the part of their energy bills that covers network costs. These costs are subject to regulatory approval.

2017/18 developments
Affordability of energy is a critical topic, as highlighted in the 2017 General Election campaign. Price caps featured in both the Conservative and Labour manifestos and an energy price cap bill is currently progressing through Parliament. The Labour Party also indicated in its manifesto that it was considering renationalising utility networks. The Government commissioned the Cost of Energy Review in the summer of 2017. Its main findings were that the cost of energy is too high, and that the energy policy, regulation and market design are not fit for the purposes of the emerging low-carbon energy market.

Our response
Our regulated business continues to strive for greater efficiency, seeking innovative ways to reduce both the time and cost to repair or replace assets. This approach minimises the costs to consumers. We have been able to generate £97 million of savings for consumers in the first five years of the RIIO arrangements.

Energy Security

Commentary
The energy system is in a phase of transition from high to low carbon. Coal plants are closing down and being replaced with nuclear, renewables and gas, as well as emerging battery storage.

2017/18 developments
UK wholesale gas prices have been trending upwards as sources of gas storage have decreased with the closure of the Rough gas field and general global shifts in preferences from coal to gas.

Our response
We received the first ever UK LNG cargos from the US and Peru, highlighting our ability to help deliver a more diverse gas supply for the UK. We also published our System Needs and Product Strategy report, which sets the scene for future requirements, and consults on the future balancing services products.

Environmental sustainability

Commentary
Our world is changing as a result of human activity and its impact on the environment. The Paris Agreement sends a clear signal that the shift to a low-carbon economy is inevitable, and it is now accepted that sustainable business is good business – creating value for people, the environment and businesses. This includes reducing greenhouse gas emissions, managing non-renewable resources, and preserving and protecting habitats and ecosystems.

2017/18 developments
During 2017, the UK saw a number of records broken for renewable energy – including the first day when wind, nuclear and solar generated more power than gas and coal. In April, the country had its first day without coal generated energy since the industrial revolution.

The UK Government published 'A Green Future: Our 25 year Plan to Improve the Environment', setting out the UK's long-term approach to protecting and enhancing the natural environment. And in July 2017 the Government announced a ban on the sale of new petrol and diesel vehicles cars from 2040.

Our response
Reducing greenhouse gas emissions forms part of the KPIs, see page 9. We are working with customers and stakeholders in the UK to gather insights on the future role of gas in managing the transition to a low-carbon future. We also continue to work with BEIS and Ofgem on the development of future energy systems as we respond to the shift to low-carbon energy in the UK. National Grid's environmental strategy, 'Our Contribution', focuses on the areas where it can make the greatest contribution.

Technology

Commentary
The interaction between the gas and electricity is changing with more gas used to create electricity than ever before. This transformation is being assisted by a range of factors: political and regulatory push, consumer pull and the rapid pace of change in digital technologies.

2017/18 developments
Digitisation of energy networks from producers and generators to households is changing how people engage with energy. We face the challenge of adapting our networks to meet new

demands, and making sure we act on the opportunities that will benefit our customers and stakeholders.

Our response

We are part of the National Grid plc Group technology and innovation team to develop our strategy with regards to new technology, to monitor disruptive technology and business model trends, and to act as a bridge for emerging technology into the core regulated businesses and business development teams.

National Grid has established a partnership with Energy Impact Partners to gain exposure to emerging start-up companies.

We are taking advantage of the latest technological innovations to improve our performance. For example, we are using robotics for gas pipeline inspection, improving asset health and lowering costs; and we continue to use digital engineering, which also helps us lower costs.

The Impact of Brexit

We believe UK-EU cooperation on energy is positive for UK and EU consumers in terms of energy security, affordability and decarbonisation.

We continue to keep the implications of Brexit under review, especially regarding our access to energy markets and the impacts on revenues and costs. Based on the worst case scenario ("no deal" on free trade), we have determined that the risk of increased costs of tariffs and any possibility that National Grid owned interconnectors may be "switched off" is low.

Throughout the year, we have been engaging with our customers and stakeholders, especially with our regulators, as we seek to inform them of Brexit outcome we believe would be in the best interests of consumers.

Our commitment to being a responsible business

Businesses should be a force for positive social and environmental change. To do this, companies have to act responsibly in everything they do, and the way in which they do it. This belief is fundamental to the way we work at National Grid.

Our approach

Businesses are a key part of the communities in which they operate, and we believe they should be aiming to leave a positive purpose-led legacy for future generations. At National Grid Gas, we work hard to bring energy to life and exceed the expectations of our customers, shareholders and communities.

The National Grid Group took part in the 2017 UK Social Mobility Index and were ranked 34th out of the 98 companies that took part. Following feedback, we have introduced changes to our recruitment processes and the data we capture so we can better understand and address social diversity. We are undertaking a significant piece of work to move the focus of our corporate responsibility activities towards supporting social mobility in the UK. We will describe the outcomes from this work in next year's report.

Being a responsible business covers every aspect of our work, both what we do and how we do it. When we are undertaking major infrastructure projects, we work with our customers, stakeholders and communities to gather their views to help inform what we do. We support communities through our employee volunteering programmes, partnering with charities and civil society, and providing community groups with financial support.

We report on a number of non-financial performance measures relating to these policies. You can find details about our key non-financial performance measures on page 9, and also on the National Grid website, in the Responsibility and Sustainability section.

Our priorities

Our priorities are shaped by the Group's strategic priorities, and a number of other factors, including the risks we face as a business, the views of our customers and stakeholders, and the challenges faced by the communities where we operate. National Grid is a signatory to the United Nation's Global Compact and support its Sustainable Development Goals (SDGs). These goals promote prosperity while protecting the planet. All 17 goals are important, and there are five (see below) that are particularly linked to our responsible business focus areas.

Environmental sustainability

We know that our business operations have the potential to affect the environment. Managing any risks, whether these are short-term through our physical operations, such as air quality and pollution, or long-term through our greenhouse gas emissions or resource use, is fundamental to our approach to environmental sustainability.

Additionally, an environmental event arising from catastrophic asset failure is one of our operational risks. You can read more about this on page 17, together with our approach to mitigation.

Our priorities

National Grid's environmental strategy, 'Our Contribution', was originally developed in 2012 with a wide range of internal and external stakeholders, and has been refined over the years to reflect changing stakeholder priorities. It focuses on three areas: climate change, resources and caring for the natural environment. Our strategy is delivered through our environmental policies. We focus on:

- reducing our carbon footprint;
- maximising the value of resources and reducing the impact on the environment through re-use and re-cycling; and
- using our land holdings in ways that benefit our business, the environment and the communities in which we live and work.

This is all underpinned by maintaining high environmental management standards.

As a company, we support climate change science. Reducing greenhouse gas emissions is an important area of focus for us, and is one of National Grid's KPIs. You can read more about this, on page 9.

We support the Paris Agreement and National Grid has made a commitment to reduce National Grid's greenhouse gas emissions by 45% by 2020, 70% by 2030 and 80% by 2050. This aligns with the trajectory required to meet the goal of the Agreement: to limit global warming to a 2°C temperature rise from 1990 levels.

In June 2017, the Financial Stability Board released its final report on the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The voluntary framework for disclosure of climate-related information in financial filings is structured around four themes: governance, strategy, risk management, and metrics and targets. We recognise the importance of these disclosures and are committed to implementing the recommendations.

This year National Grid wasdelighted to win Business in the Community's Award for Environmental Leadership.

People

We are working hard to overcome some of the biggest energy challenges of the 21st century. We need to make sure we have highly motivated people, with the right skills, working for us, and helping equip us for the future.

Our focus on people covers our current and future employees. We aim to have an engaged and diverse workforce to stimulate innovation, reflect the communities where we work, and deliver great customer service.

The culture we strive for stems from embracing our values of 'Doing the right thing' and 'Finding a better way'. You can read more about our values on page 7.

We also know that building sufficient capability and leadership capacity (including effective succession planning) is an important factor in delivering our vision and strategy. You can read more about how we are mitigating this on page 18.

Engaging our people

Through our approach to developing our people and the wider benefits of working at National Grid we aim to have an engaged and productive work force. To attract and retain employees we make sure our remuneration package is both fair and competitive. Through a third party company, we also carry out an annual employee survey to measure engagement levels and to help us address areas employees believe we need to improve. Employee engagement forms one of our KPIs – you can read more about this and our performance on page 9.

The wellbeing of our workforce is also important. This year our employee lost time injury frequency rate improved to 0.05. Our KPI is to achieve a safety performance below 0.10.

Safeguarding the future

We continue to raise awareness of the career opportunities in the energy utility industry. The need for a skilled workforce to develop, deliver and use new technologies within the energy sector is becoming more acute according to the EU Skills Workforce Strategy. Science, Technology, Engineering and Mathematics (STEM) skills underpin our business, and we promote STEM as an exciting career path for young people through education outreach activity such as the Big Bang Fair, work experience, and hosting school visits to our sites.

Whistleblowing

We have confidential external whistleblowing helplines available 24/7. We publicise the contact information to our employees and on our external website so concerns can be reported anonymously. Our policies make it clear that we will support and protect 'whistle-blowers' and any form of retaliation will not be tolerated.

Promoting an inclusive and diverse workforce

In 2017 we implemented inclusion and diversity policies. The purpose of the policies is to demonstrate our commitment to providing an inclusive, equal and fair working environment through:

- driving inclusion and promoting equal opportunities for all;
- ensuring the workforce, whether part-time, full-time or temporary, will be treated fairly and with respect;
- eliminating discrimination; and
- ensuring selection for employment, promotion, training, development, benefit and reward, will be on the basis of merit.

12% of our total workforce has declared themselves to be of 'minority' racial or ethnic heritage. We recognise the value a diverse workforce and an inclusive culture bring to our business and have many initiatives to encourage and promote this. For example, our UK employee resource groups created our second edition of 'Remarkable', which highlights the full diversity of our people. We have implemented a diverse panel interview approach to appoint senior leaders.

The gender demographic table that follows shows the breakdown in numbers of employees by gender at different levels of the organisation. We define 'senior management' as those managers who are at the same level, or one level below, our Executive Committee. It also includes those who have responsibility for planning, directing or controlling the activities of the Company, or a strategically significant part of the Company, and are employees of the Company.

Gender	Financial year ending 31 March 2018				
	Male	Female	Total	% Male	% Female
Our Board	5	3	8	63	37
Senior Management	30	14	44	68	32
Whole Company	1,403	731	2,134	66	34

Ethnicity demographic as at financial year end 31 March 2018

'Minority' refers to racial/ethnic heritage declarations recorded in our system. Those who have not stated their ethnicity are excluded from the baseline.

White	1,675
Minority	236
Total	**1,911**
White (%)	88%
Minority (%)	12%

Our role in communities

An important part of our vision is to exceed the expectations of our communities. We do this by providing a safe and reliable service, and by helping our communities to thrive through our responsible business activities. We also know that, from time-to-time, when we are carrying out large construction projects that our work can have a negative impact on communities. We work with communities to reduce this impact and to help support their social and economic needs.

Safe reliable energy

Providing a reliable and safe service at as low a cost as possible is important to our customers and to us as we work hard to exceed their expectations.

The safety of our employees, contractors and the public is one of our highest priorities and this is reflected in our KPI's, described on page 9. We have policies, procedures and training in place to make sure we maintain our safety performance at the high level that we expect.

The reliability of our networks is world class, running at more than 99.9% availability. You can read more about this on page 9 as well as how we manage our operational risks on page 17.

Supporting communities to thrive

We don't just supply power to communities, we are part of them. As a purpose-led organisation, we believe that helping to build strong communities is good for the people who live there, good for our business and good for the wider economy.

We achieve this by partnering with civil society, providing communities with one-off grants to support their social, economic and environmental development. We encourage our employees to pursue skills-based volunteering and fundraising opportunities. In the future, we will be focusing on helping to address social mobility in the UK.

National Grid voluntarily set up a £150 million Warm Home Fund after the sale of a 61% stake in the UK Gas Distribution business to help address fuel poverty. To date, National Grid has given out just over £63 million to improve homes and help people across England, Wales and Scotland by, for example, enabling them to have central heating systems for the first time.

Our employees also support local schools and colleges with work experience opportunities and careers advice sessions. Last year we had more than 35,000 quality STEM interactions with young people across the National Grid plc group.

Investing in future generations links in with one of our strategic priorities to ensure that National Grid Gas Plc is better equipped for the future. National Grid is part of the Government's Inclusive Economic Partnership, a partnership between the business sector, Government and Civil Society. We are supporting work in the vital areas of mental health in the workplace and equipping people to successfully transition to the world of work.

Preventing modern slavery

We strive to make sure that modern slavery is not taking place anywhere in our business or in our supply chain. We recognise that we are reliant on our suppliers to deliver our human rights requirements within their own supply chains and we expect all suppliers to be compliant with the Modern Slavery Act. Each year we publish our modern slavery statement on the National Grid website.

We work with our suppliers and peers to understand what approach they are taking to combat modern slavery. In 2017 the group completed a desktop risk assessment of the group's top 250 suppliers. We are now engaging with those suppliers that have been identified as potentially high risk and will be working with them to complete a range of assessment questions to develop risk mitigation plans for any identified issues.

We are also developing a framework for our buyers so that the sustainability risk criteria, including modern slavery, can be embedded into the initial stages of the sourcing process and integrated into the selection criteria. Any risks identified will be reviewed through the contract management process.

Good business conduct

To provide an understanding of the company's development, performance and position, we describe our respect for human rights, anti-corruption and anti-bribery matters below.

Human rights
Respect for human rights is incorporated into our employment practices and our values, which are integral to our ethical business conduct guide – the way in which we conduct ourselves allows us to build trust with the people we work with.

We earn this trust by doing things in the right way, and by building our reputation as an ethical company that our stakeholders want to do business with and our employees want to work for. However, due to the jurisdictions in which we operate, the nature of the work we undertake, and our associated supply chain, human rights is not considered to be a principal risk to our business.

Although we do not have specific policies relating to human rights, slavery or human trafficking, our procurement policies integrate sustainability into the way we do business throughout our supply chain, so that we create value, preserve natural resources and respect the interests of the communities we serve and from which we procure goods and services.

Through our Supplier Code of Conduct we expect our suppliers to keep to all laws relating to their business, as well as adhere to the principles of the United Nations Global Compact, the Ethical Trading Initiative Base Code, the UK Modern Slavery Act 2015, and the requirements of the Living Wage Foundation.

Anti-bribery and corruption
We have policies and governance in place that set and monitor our approach to being responsible, including Our Code of Business Conduct (covering bribery and corruption). We have a Company-wide framework of controls designed to prevent and detect bribery.

We investigate all allegations of ethical misconduct thoroughly, and where appropriate, we take corrective action. We also record trends and metrics relating to such allegations – only a small percentage of these relate to bribery or corrupt practices, so we do not consider them to be material for reporting purposes. For the seventh successive year we have been awarded the World's Most Ethical Business title from Ethisphere.

Governance and oversight
We regularly review and update our framework so we can make sure our procedures remain proportionate to the principle risks we have identified.

Our Ethics and Compliance Committee (ECC) oversees the Code of Ethical Business Conduct and associated awareness programmes. Any cases alleging bribery are required to be referred immediately to the ECC so the members can satisfy themselves that cases are investigated promptly and where appropriate, acted upon, including ensuring any lessons learnt are communicated across the business.

The Audit Committee receives an annual report on the procedures currently in place to prevent and detect bribery. You can read more about the Audit Committee's role on pages 28 and 29. None of our investigations over the last twelve months have identified cases of bribery.

Anti-bribery policy
the National Grid Policy Statement – Anti Fraud and Bribery applies to all permanent employees, temporary agency staff and contractors. It sets out our zero tolerance approach to bribery.

To ensure compliance with the UK Bribery Act 2010, we carried out a risk assessment across the Company so we could highlight higher risk areas and make sure adequate procedures were in place to address them. We introduced an e-learning course for all employees so they can adequately understand the Company's zero tolerance approach to fraud, bribery or corruption of any kind.

Ethical business conduct
We follow the National Grid Group Code of Ethical Business Conduct, which sets out the standards and behaviours we expect from all employees to meet our values of Do the Right Thing and Find a Better Way. The document is issued to all employees and is supported by a regular programme of communications to promote a strong ethical culture. Additionally, we provide briefings for high risk areas of the business, such as Procurement.

Suppliers
Our Supplier Code of Conduct is issued to our suppliers and sets out our requirements that they have in place a programme with procedures to prevent and detect bribery and corruption, in accordance with all applicable laws or regulations, including the UK Bribery Act 2010.

We provide specific guidance and briefings for high risk areas, so contractors, agents and others who are acting on behalf of National Grid Gas Plc do not engage in any illegal or improper conduct. Our Global Procurement team carries out regular supplier screening to identify any requirements for prosecutions or sanctions within our supplier base.

Compliance framework
Each of our business areas are required to consider their specific risks and maintain a compliance framework setting out the controls they have in place to prevent bribery. Every six months, as part of the compliance procedure, the business is asked to self-assess the effectiveness of their controls and provide evidence that supports their compliance.

Each year, all function heads are asked to certify the compliance in their area, and to provide details of any exceptions. This culminates in presentation of a Certificate of Assurance from the National Grid plc CEO to the National Grid plc Board (following consideration by the National Grid plc Audit Committee).

Internal control and risk management

The National Grid Gas Board is committed to protecting and enhancing our reputation and assets, while safeguarding the interests of our stakeholders. It has overall responsibility for the Company's system of risk management and internal control.

Managing our risks

National Grid Gas is exposed to a variety of uncertainties that could have a material adverse effect on its financial condition, its operational results, its reputation, and the value and liquidity of its shares.

The National Grid Gas Board oversees the Company's risk management and internal control systems as it relates to our gas operations. The Board assesses these risks and monitors the risk management process through risk review and challenge sessions twice a year.

Risk management process

Overall risk strategy, policy and process are set at the Group level by National Grid plc with implementation owned by National Grid Gas. Our enterprise risk management process provides a framework through which we can consistently identify, assess and prioritise, manage, monitor and report risks.

Our UK Regional risk profile, which is presented to the National Grid Gas Board biannually, contains the most important gas and electric risks currently facing the company as we endeavour to achieve our strategic objectives. We agree these top risks through implementation of our top-down/bottom-up risk management process. The risks are reported and debated with the National Grid UK Executive Committee every three months.

A broad range of factors are considered when determining our most important risks. The potential for nationalisation of energy supply networks by the UK Labour Party continues to be kept under review. Should the UK Labour Party come into power, the timing and route to energy supply network nationalisation generally is uncertain, and therefore the impact upon National Grid Gas remains unclear. Options considered have included acquisition of the listed plc, the UK business, the transfer of transmission assets to 'regional communities' and regulatory change. The Government would have to pay compensation for the Company's property, which would be determined at the time, but would be an amount reasonably related to the value of the property taken. We have taken a number of steps, including canvassing a wide range of stakeholders – government officials, consumers, members of the public – to understand the impact of nationalisation on certain stakeholder groups.

In addition to the issues above, senior leaders have also considered certain aspects of the risks in more detail, including cyber security and Brexit.

The UK Regional risk profile informs the National Grid Principal Risk profile which is tested annually to establish the impact on the company's ability to continue operating and to meet its liabilities over a specified assessment periodThe impact of these risks are tested on a reasonable worst case basis, alone and in clusters, the result of which is utilised to develop our viability statement. The National Grid Board, National Grid Group Executive Committee and other leadership teams discuss the results of the annual testing of our principal risks at the end of the year.

Changes during the year

Significant changes have been made to the UK Regional risk profile as a result of UK Executive Committee workshops in 2017 including the addition of new risks, removal of existing risks and the rewording and/or consolidation of several risks to better reflect the current meaning of the risk. Additionally this year, a reassessment of the Company's risk appetite resulted in the establishment of a system of classification of risks into categories (Operational, Strategic, Regulatory, People and Financial) which is utilised in our reporting.

The UK Regional risk profile as it relates to gas operations is presented in table below.

Internal Controls

There has been a National Grid Group wide focus on internal control improvement throughout the year. This review resulted in observations across a number of key UK processes and included a focus on the reliance placed on the data used in controls and on third-party reports, and the precision of key review controls.

In response, the UK Executive leadership defined a comprehensive multi-year control programme to identify and implement solutions to optimise the UK business control environment while continuing to focus on the real-time need of addressing the findings of the National Grid Group led SOX refresh programme in the short term.

The UK Executive Committee and the National Grid Gas Audit Committee has challenged management on its progress on mitigating control observations as they arose and requested additional insight into areas which were subject to shorter-term fixes. The Committee sought additional context from management on its assessment of the severity of the matters identified, the identification of mitigating controls and the impact on the year-end aggregation exercise.

After careful consideration the Committee concurred with management's overall assessment that the company's internal control over financial reporting is effective.

Our principal risks and uncertainties

Accepting that it is not possible to identify, anticipate or eliminate every risk that may arise and that risk is an inherent part of doing business, our risk management process aims to provide reasonable assurance that we understand, monitor and manage the main uncertainties that we face in delivering our objectives. This includes consideration of inherent risks, which exist because of the nature of day-to-day operations in our industry, and financial risks, which exist because of our financing activities. Our principal risks and a summary of management and mitigation actions are provided in the table below.

<table>
<tr><td rowspan="2">Operational risks</td><td colspan="2">Operational risks relate to the risk of losses resulting from inadequate or failed internal processes, people and systems or due to external events. We normally have low appetite for such risks, as there is no strategic benefit from accepting risks which are not in line with our vision and values.

Our operational principal risks have a low likelihood of occurring but have a high level of impact should the event occur without effective prevention and mitigation controls. The risk owners, executive leaders, and their teams develop and monitor actions to control the risks. Operational risks are managed through policy, standards, and procedure based controls, active prevention and monitoring. The operational risks link to our strategic priority of, 'Find new ways of optimising our operational performance'. Principal risk assessment includes reasonable worst case scenario testing – i.e. gas transmission pipeline failure, loss of licence to operate, cyber security attack – and the financial and reputational impact should a single risk or multiple risks materialise. External events over this past year including extreme weather events, the WannaCry cyber security attack, and new data privacy legislation were considered in the assessment and testing, as well as in the development of mitigation actions.</td></tr>
<tr><td>Risks

Catastrophic major hazard asset failure results in a significant safety event.

Risk trend:

Failure of critical national infrastructure (CNI) IS Systems.

Risk trend:

Major cyber security breach of business and CNI systems/data.

Risk trend:

Failure of a Business Critical Enterprise (non-CNI) IS System or Systems.

Risk trend:

We will fail to meet gas supply and fail to deliver obligations.

Risk trend:

Our workers, contractors or members of the public experience an occupational safety incident that results in a fatal or life-changing injury.

Risk trend:</td><td>Actions taken by management

We continue to commit significant resources and financial investment to maintaining the integrity and security of our assets and data. This year, we have continued to focus on risk mitigation actions designed to reduce risk and help meet our business objectives. Monitoring action statuses has been incorporated into various business processes and senior leadership meetings. Examples of actions include:

• A National Grid Group-wide process safety management system is in place to make sure a robust and consistent framework of risk management exists across our higher hazard asset portfolio.
• We continually invest in strategies that are commensurate with the changing nature of the security landscape. This includes collaborative working with the Centre for Protection of National Infrastructure (CPNI) on key cyber risks, as well as development of an enhanced CNI security strategy.
• Business continuity and emergency plans are in place and practised to ensure we quickly and effectively respond to a variety of incidents – storms, physical and cyber-related attacks, environmental incidents and asset failures.
• Safety plans have been developed to identify key risks and mitigation actions implemented as appropriate.
• We have a mature insurance strategy that uses a mix of self-insurance, captives and direct (re)insurance placements. This provides some financial protection in respect of property damage, business interruption and liability risks.</td></tr>
</table>

<table>
<tr>
<td rowspan="2">Strategic and regulatory risks</td>
<td colspan="2">Strategic risk is the risk of failing to achieve the Company's overall strategic business plans and objectives as well as failing to have the 'right' strategic plan. We voluntarily accept some risk so we can generate the desired returns from our strategy.

Management of strategic risks focuses on reducing the probability that the assumed risk would materialise and improving the Company's ability to effectively respond to the risk should it occur. The risk owners, executive leaders, and their teams develop and monitor actions to control the risks. These risks link to our strategic priorities of, 'Look for opportunities to grow our core business' and 'make sure National Grid is better equipped for the future.' The political climate and policy decisions of our regulators this past year were key considerations in assessing our risks.</td>
</tr>
<tr>
<td>Risks

By the end of RIIO T1 we have failed to secure adequate new allowances. This will make it harder to deliver performance commitments to shareholders and customers.

Risk trend:

We are unable to secure an acceptable RIIO – T2 outcome for the UK Regulated Businesses.

Risk trend:

We are unable to transform the customer experience as quickly as we would like because required capacity and /or capability is not available in all entities.

Risk trend:

We fail to manage the business according to the terms of the licenses and laws we operate under and thereby risk reputational damage, higher costs and / or a fine.

Risk trend:

External pressures adversely impact achievement of Business objectives

Risk trend:</td>
<td>Actions taken by management

• We strive to maintain a good understanding of the regulatory agenda and emerging issues, so that robust, public interest aligned responses can be selected and developed in good time. Our reputation as a competent operator of important national infrastructure is critical to our ability to do this. We have plans and governance structures in place to address specific issues such as RIIO-T2 and continuously work to foster open and effective relationships with our regulators and other stakeholders.

• Our understanding of regulatory obligations and accountabilities is enhanced through the conduct of mapping exercises. Action plans have been effectively implemented to mitigate non compliances and control weaknesses.

• Threats and opportunities related to external and political pressure are discussed with internal and external stakeholders thereby ensuring our knowledge and communication channels remain current.</td>
</tr>
<tr>
<td rowspan="2">People</td>
<td colspan="2">It is through the high-quality work of our employees that we will achieve our vision, respond to the changing needs of our stakeholders and create a competitive advantage. Obtaining and fostering an engaged and talented team that has the knowledge, training, skills and experience to deliver our strategic objectives is vital to our success. We must attract, integrate and retain the talent we need at all levels of the business.</td>
</tr>
<tr>
<td>Risks

We cannot attract, recruit, develop or retain people with the right skills and capabilities to deliver our strategy and UK priorities.

Risk trend:</td>
<td>Actions taken by management

Strategic workforce planning has been embedded in our organisation. This process helps to effectively inform financial and business planning as well as human resourcing needs.

Our entry level talent development schemes (e.g. apprenticeships) are a potential source of competitive advantage in the market place. We are involved in a number of initiatives to help secure the future engineering talent required including the UK annual residential work experience.

We maintain a clear strategic focus on talent through the creation of aligned talent plans with agreed metrics.</td>
</tr>
</table>

Our internal control process

We have a number of processes to support our internal control environment. These processes are managed by dedicated specialist teams, including risk management, ethics and compliance management, corporate audit and internal controls, and safety, environment and health. Oversight of these activities is provided through regular review and reporting to the Board and appropriate Board committees as outlined in the Corporate Governance section on pages 25 to 30.

Monitoring internal control is conducted through established boards and committees at different levels of the National Grid plc organisation. Deficiencies are reported and corrected at the appropriate entity-level. The most significant risk and internal controls issues are monitored at the Senior Executive and National Grid plc Board level. The National Grid Audit Committee is responsible for keeping under review and reporting to the Board on effectiveness of reporting, internal control policies, UK Bribery Act legislation, appropriateness of financial disclosures and procedures for risk and compliance management, business conduct and internal audit.

Reviewing the effectiveness of our internal control and risk management

The Audit Committee continually monitors and assesses the effectiveness of our internal control systems and risk management processes covering all material systems, including financial, operational and compliance controls, to make sure they remain robust.

The latest review covered the financial year to 31 March 2018 and the period to the approval of this Annual Report and Accounts. In this review, the Board considered the effectiveness of areas such as the control environment, risk management and internal control activities, including those described below.

Fostering a culture of integrity is an important element of our risk management and internal controls system. National Grid's values: 'do the right thing' and 'find a better way' provide a framework for reporting business conduct issues, educating employees and promoting a culture of integrity at all levels of the business. We have policies and procedures in place to communicate behaviour expected from employees and third parties, and to prevent and investigate fraud and bribery and other business conduct issues. We monitor and address business conduct issues through several means, including a bi-annual review by the Audit Committee.

Overall compliance strategy, policy and frameworks are set at the National Grid plc Group-level with implementation owned by National Grid Gas. The business is responsible for identifying compliance issues, continuous monitoring, and developing actions to improve compliance performance. We monitor and address compliance issues, through several means including reviews leadership meetings and a bi-annual review by the Audit Committee.

A feature of our internal controls system is our three lines of defence model. This model is a way of explaining the relationship between functions and how responsibilities for risk and controls are allocated and monitored. Each business function owns and is responsible for managing its own particular risk and controls (the first line of defence). Central management teams (the second line of defence) act as an advisory function on implementing the principal risk assessments and actions taken to mitigate and manage those risks. The internal audit function then audits selected controls to provide independent assessments of the effectiveness of our risk management and internal control systems (the third line of defence).

The Certificate of Assurance (CoA) from the Chief Executive of National Grid to the National Grid Board provides overall assurance around the effectiveness of our risk management and internal controls systems. The Certificate of Assurance (CoA) process operates via a cascade system and takes place annually in support of the financial end of year review. The CoA's from senior managers within National Grid provide upwards assurance on the risk management and internal controls systems for their areas of responsibility. The National Grid Chief Executive's certificate was prepared using the information provided to him in the certificates of the National Grid Group Executive Committee members and was the final certificate presented to the National Grid Audit Committee and National Grid Board for review and consideration.

The periodic reports on management's opinion on the effectiveness of internal controls over financial reporting are received by the National Grid Gas Audit Committee and Board in advance of the full-year results.

Internal control over financial reporting

We have specific internal mechanisms that govern the financial reporting process and the preparation of the Annual Report and Accounts. Our financial controls guidance sets out the fundamentals of internal control over financial reporting, which are applied across the Company. Our financial processes include a range of system, transactional and management oversight controls. In addition, our businesses prepare detailed monthly management reports that include analysis of their results, along with comparisons to relevant budgets, forecasts and prior year results. These are presented to, and reviewed by, senior management within our Finance function.

These reviews are supplemented by quarterly performance reviews, attended by the UK CEO and UK CFO. The reviews consider historical results and expected future performance and involve senior management from both operational and financial areas of the business. Each month, the UK CFO presents consolidated financial report to the Board.

Viability statement

The Board's consideration of the longer-term viability of the Company is an extension of National Grid plc's business planning process. This includes financial forecasting, a robust risk management assessment, regular budget reviews and scenario planning incorporating industry trends and economic conditions. Our business strategy aims to enhance our long-term prospects by making sure our operations and finances are sustainable.

National Grid Gas plc (NGG) is a wholly-owned subsidiary of National Grid plc which performed a group wide business plan that was reviewed and approved by the National Grid plc Board and which included details of the NGG operating segment.

The Board have concluded that five years is the most appropriate timeframe over which to assess the long-term viability of the Company given our business model, current regulatory clarity, other factors impacting our operating environment, and the robustness of our business planning process. This is in line with our five year business plan and one year budget which are reviewed and approved by the National Grid plc Board.

The business plan considers the significant solvency and liquidity risks involved in delivering our business model in light of our strategic priorities. The business plan models upside and downside scenarios derived from the risks and opportunities identified, and determines the impact these would have on our results and financial position over the five-year period. We have set out the details of the principal risks facing our Company on pages 17 to 18, described in relation to our ability to deliver our strategic objectives. We identify our principal risks through a robust assessment that includes a continuous cycle of bottom up reporting and review, and top down feedback.

The business model calls for significant capital investment to maintain and expand our network infrastructure. To deliver this, our business plan highlights that we will need to access capital markets to raise additional funds from time to time. We have a long and successful history in this regard. Our business plan also models various KPIs used by lenders in assessing a company's credit worthiness. These models indicate that we would continue to have access to capital markets at commercially acceptable interest rates throughout the five-year period.

The National Grid plc Board assessed our financial "headroom", and reviewed principal risk testing results against that headroom. No principal risk or cluster of principal risks was found to have an impact on the viability of the Company over the five-year assessment period. Preventative and mitigating controls in place to minimise the likelihood of occurrence and/or financial and reputational impact are contained within our assurance system.

The NGG Board review and approve the annual certificates in respect of compliance with certain licence conditions (including Financial Ring-fencing and Availability of Resources). The Electricity Transmission Financial Ring-fencing certificate was approved by the Board in March 2018, and the Availability of Resources certificate was issued in July 2017, the next Availability of Resources certificate will be issued in July 2018.

In assessing the impact of the principal risks on the Company, the Board has considered the fact that we operate in stable markets and the robust financial position of the Company, including the ability to raise capital and suspend or reduce the payment of dividends. It has also considered Ofgem's legal duty to have regard to the need to fund licenced NGG activities.

Based on the assessment described above and on page 31, the Directors have a reasonable expectation that the Company will be able to continue operating and meet its liabilities over the period to June 2023.

The Strategic Report was approved by the Board of Directors on 21 June 2018 and signed on its behalf by:

Alan Foster
UK CFO

Financial review

We have delivered another year of solid financial performance. Revenue from continuing operations increased by £84 million to £1,424 million, and adjusted operating profit increased by £74 million to £647 million.

Use of adjusted profit measures

In considering the financial performance of our business and segments, we use various adjusted profit measures in order to aid comparability of results year on year.

The various measures are presented and reconciled below.

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

The first of these components is referred to as an adjusted profit measure, also known as 'Headline' or a' business performance' measure. This is the measure used by management that forms part of the incentive target set annually for remunerating certain Executive Directors. Adjusted results exclude exceptional items and remeasurements. These items are reported collectively as the second component of the financial measures. Note 3 explains in detail the items which are excluded from our adjusted profit measures.

Adjusted profit measures have limitations in their usefulness compared with the comparable total profit measures as they exclude important elements of our financial performance. However, we believe that by presenting our financial performance in two components it is easier to read and interpret financial performance between periods, as adjusted profit measures are more comparable having removed the distorting effect of the excluded items. Those items are more clearly understood when separately identified and analysed.

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

Management uses adjusted profit measures as the basis for monitoring financial performance. These measures are also used in communicating financial performance to its investors in external presentations and announcements of financial results.

Internal financial reports, budgets and forecasts are primarily prepared on the basis of adjusted profit measures, although planned exceptional items, such as significant restructurings, are also reflected in budgets and forecasts. We separately monitor and disclose the excluded items as a component of our overall financial performance.

Reconciliations of adjusted profit measures

Reconciliation of adjusted operating profit to total operating profit

Adjusted operating profit is presented on the face of the income statement under the heading operating profit before exceptional items.

	Years ended 31 March	
Continuing	**2018**	2017
	£m	£m
Adjusted operating profit	**647**	573
Exceptional items	**-**	(109)
Total operating profit	**647**	464

Reconciliation of adjusted operating profit to adjusted earnings and earnings

	Years ended 31 March	
Continuing	**2018**	2017
	£m	£m
Adjusted operating profit	**647**	573
Adjusted net finance costs	**(196)**	(155)
Adjusted profit before tax	**451**	418
Adjusted taxation	**(98)**	(66)
Adjusted profit after tax	**353**	352
Attributable to non-controlling interests	**-**	-
Adjusted earnings	**353**	352
Exceptional items after tax	**-**	(47)
Remeasurements after tax	**17**	(6)
Earnings	**370**	299

Reconciliation of adjusted operating profit excluding timing differences to total operating profit

Adjusted profit excluding timing differences is presented below.

	Years ended 31 March	
Continuing	**2018**	2017
	£m	£m
Adjusted operating profit excluding timing differences	**665**	511
Timing differences[1]	**(18)**	62
Adjusted operating profit	**647**	573
Exceptional items	**-**	(109)
Total operating profit	**647**	464

[1] Our operating profit for the year includes a total estimated in-year under-collection of £18 million (2016/17: £62 million over-collection).

Consolidated income statement commentary

The commentary below describes the continuing business results for the year ending 31 March 2018.

	Years ended 31 March	
	2018	2017
	£m	£m
Revenue	1,424	1,340
Operating costs	(777)	(767)
Operating profit	647	573
Exceptional items	-	(109)
Finance income	8	5
Finance costs:		
Before exceptional items and remeasurements	(204)	(160)
Exceptional items and remeasurements	21	(7)
Profit before tax	472	302
Taxation:		
Before exceptional items and remeasurements	(98)	(66)
Exceptional items and remeasurements	(4)	63
Profit after tax	370	299

Revenue

Revenue for the year ended 31 March 2018 increased by £84 million to £1,424 million. The increase in revenue is reflective of increased exit capacity allocations due to an increase in prices, combined with an increase in sales to Cadent which is now classified as external following the sale of the Gas Distribution business in 2016/17.

Operating profit

Adjusted operating profit for continuing operations for the year ended 31 March 2018 of £647 million represents an increase against last year of £74 million.

Exceptional items of £109 million included in our operating costs for the year ended 31 March 2017 relate to £109 million gain on the sale of land sites, offset by the creation of £107 million of gas holder demolition provisions, £89 million of costs incurred due to sectionalisation of the National Grid UK Pension Scheme and £22 million of pension deficit charges.

The results for 2017/18 include a release of a one off dilapidations provision of £11m for the demolition of the LNG Storage site in Avonmouth. The provision was made in 2014/15 when there were plans to demolish the Avonmouth site and remarket it as a brownfield site for sale. In 2017/18 a number of the conditions for sale were reached and it is expected that the remaining conditions will be met soon so it is highly unlikely that the tanks would ever need to be demolished, hence no dilapidation provision was retained at 31 March 18.

Net finance costs

For the year ended 31 March 2018, net finance costs of £196 million are £41 million higher than the prior year, principally driven by higher RPI rates during the year impacting our index linked debt.

Taxation

The tax charge on profits before exceptional items and remeasurements was £32 million higher than 2016/17. This was due to the non-recurrence of one-off prior year tax credits and increased profits in the year offset by a benefit from a 1% reduction in the UK taxation rate.

Consolidated statement of financial position commentary

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.

	Years ended 31 March	
	2018	2017
	£m	£m
Non-current assets	9,046	8,762
Current assets	2,184	2,447
Total assets	11,230	11,209
Current liabilities	(1,690)	(1,787)
Non-current liabilities	(5,039)	(5,583)
Total liabilities	(6,729)	(7,370)
Net assets	4,501	3,839

Property, plant and equipment

Property, plant and equipment increased by £77 million to £4,416 million as at 31 March 2018. This was due to capital expenditure of £324 million, offset by £213 million of depreciation in the year and disposals of £24 million.

Other non-current assets

Other non-current assets comprises an interest-free loan to our immediate parent company National Grid Gas Holdings Limited of £3,427 million, and non-current prepayments which increased by £84 million.

Trade and other receivables

Trade and other receivables have decreased by £206 million to £314 million at 31 March 2018. This decrease is principally due to a decrease in amounts owed by fellow subsidiaries of £121 million and a decrease in prepayments of £92 million which is largely as a result of reclassification to non-current.

Derivative financial instruments

The £33 million decrease in derivative value is mainly due to foreign exchange rate movements impacting our cross currency swaps offset by swap terminators associated with restructuring of the financing portfolio.

Trade and other payables

Trade and other payables have increased by £18 million to £632 million. This was mainly due to an increase in amounts due to fellow subsidiaries of £28 million.

Current and deferred tax liabilities

Current and deferred tax liabilities have increased by £89 million to £464 million. This was mainly as a result of the increase in the pension scheme asset.

Provisions

Provisions (both current and non-current) decreased by £88 million in the year largely relating to utilisation of provisions relating to business set up costs and business restructuring costs on the disposal of Gas Distribution.

Other non-current liabilities

Other non-current liabilities decreased by £12 million to £177 million due primarily to the crop and quarry accrual being reclassified to provisions.

Other balance sheet items

During the year ended 31 March 2017 pension sectionalisation occurred within the National Grid plc Group, with the National Grid UK Pension Scheme being split into three parts, Sections A, B and C. National Grid Gas became a sponsoring employer for Section B. This has resulted in a change in National Grid Gas from recognising a pension charge for the year and recognising the scheme as if it were a defined contribution scheme to recognising a net pension asset on the balance sheet and accounting as a defined benefit scheme.

We operate pension arrangements on behalf of our employees the majority of whom are members of the defined benefits section which is closed to new entrants. Membership of the defined contribution section of the National Grid Pension Scheme is offered to all new employees.

Net pensions obligations

A summary of the total assets and liabilities and the overall net IAS 19 (revised) accounting surplus is shown below:

Net scheme asset	£m
As at 1 April 2017	45
Current service cost	(18)
Net interest cost	-
Administration and other	(7)
Actuarial gains	
on plan assets	330
on plan liabilities	-
Employer contributions	62
As at 31 March 2018	412

The principal movements in the pension asset during the year include net actuarial gains of £330 million and employer contributions of £62 million. The overall obligation moved by £367 million to a closing asset of £412 million.

Further information on our pensions benefit obligations can be found in notes 19 and 26 to the consolidated financial statements.

Cash flow statement commentary

The commentary below describes the continuing business results for the year ending 31 March 2018.

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	2018 £m	2017 £m
Cash generated from operations	956	723
Net capital expenditure	(324)	(246)
Business net cash flow	632	477
Net interest paid	(92)	(88)
Tax received / (paid)	16	(30)
Dividends paid	-	(8,100)
Discontinued operations	(329)	7,249
Other	139	5,759
Net debt decrease	366	5,267
Opening net debt	(3,185)	(8,452)
Closing net debt	(2,819)	(3,185)

Cash generated from operations

Cash flows from our operations are largely stable when viewed over the longer term. Our gas transmission operation is subject to multi-year price control agreements with Ofgem.

For the year ended 31 March 2018, cash flow from operations increased by £233 million to £956 million. Changes in working capital decreased by £143 million from the prior year, principally due to an increase in payables and current accounts.

Net capital expenditure

Net capital expenditure in the year of £324 million was £78 million higher than the prior year.

Dividends paid

National Grid Gas did not pay any dividends in 2017/18. This was £8,100 million lower than 2016/17 (see note 6). The 2016/17 dividends were made to ensure partial distribution of the proceeds from the Gas Distribution business.

Discontinued operations

The Gas Disposal business contributed £7,249 million to the cash flow in the prior year, primarily due to proceeds from the sale and debt restructuring within investing activities of £6,585 million. Cash flows from operations were £460 million and cash flows from financing activities were £204 million.

Regulated financial performance

Timing and Regulated Revenue Adjustments

Our allowed revenues are set in accordance with our regulatory price controls. We calculate the tariffs we charge our customers based on the estimated volume of energy and cost we expect will be delivered during the coming period. The actual volumes delivered will differ from this estimate. Therefore, our total actual revenue will be different from our total allowed revenue. These differences are commonly referred to as timing differences. If we collect more than the allowed level of revenue, the balance must be returned to customers in subsequent periods, and if we collect less than the allowed level of revenue we may recover the balance from customers in subsequent periods.

In addition to the timing adjustments described above, following the start of the RIIO price controls outperformance against allowances as a result of the totex mechanism, together with changes in output-related allowances included in the original price control, will almost always be adjusted in future revenue recoveries, typically starting in two years' time.

Our current IFRS revenues and earnings will therefore include these amounts that will need to be repaid or recovered in future periods. Such adjustments will form an important part of the continuing difference between reported IFRS results and underlying economic performance based on our regulatory obligations.

Return on Equity

Return on Equity for the year, using a long-run inflation rate of 3%, was 10.0% compared with a regulatory assumption, used in calculating the original revenue allowance, of 10.0%. The principal components are shown in the table below.

Year ended 31 March	2018	2017
Base return (including avg. 3% long-run inflation)	10.0%	10.0%
Totex incentive mechanism	(0.8)%	(0.8)%
Other revenue incentives	1.2%	1.1%
Return including in year incentive performance	10.4%	10.3%
Pre-determined additional allowances	(0.4%)	0.5%
Return on Equity	10.0%	10.8%

The business performed below the targets set by the totex incentive mechanism in the fifth year of RIIO. Totex spend was £476m, compared to an estimated allowance, adjusted for outputs and phasing of £438m, however this was in line with prior year overall totex performance. The Company's share of this difference is expected to be £17m.

The business had another good year of incentive performance, slightly up on 2016/17. Overall, the Gas Transmission business delivered around 120 bps of additional returns through other revenue incentives. The majority of this was from strong performance on constraint management transmission support services and shrinkage incentives. On a pre-tax basis, this equates to an estimated £30m of additional revenue allowance, most of which is due to be recovered in future years under the RIIO funding mechanisms.

Cessation of legacy revenue allowances, as expected, led to the reduction in pre-determined additional allowances.

Regulated Financial Position

RAV increased by 4.5% in the year, reflecting the impact of inflation and a planned increase in asset health spend and increase on the Feeder 9 project under the Humber Estuary. Net other regulatory assets decreased by £91 million, mainly reflecting revenues associated with Avonmouth which will start to be repaid next year and an over-recovery on pension deficit payments.

£m	2018	2017
Opening Regulated Asset Value (RAV)*	5,755	5,597
Asset additions (aka slow money) (actual)	304	201
Performance RAV or assets created	(16)	(11)
Inflation adjustment (actual RPI)	194	175
Depreciation and amortisation	(223)	(207)
Closing RAV	6,014	5,755
Opening balance of other regulated assets and (liabilities)*	(34)	56
Movement	(91)	(120)
Closing balance	(125)	(64)
Closing Regulated Financial Position	5,889	5,691

*2017/18 opening balances adjusted to correspond with 2016/17 regulatory filings and calculations

Discontinued operations

Discontinued operations comprise the Gas Distribution and Xoserve businesses. The results of the discounted operations are presented below:

	Years ended 31 March	
	2017	2016
Discontinued operations	£m	£m
Revenue	927	1,913
Operating costs	(531)	(1,056)
Operating profit	396	857
Net finance costs	(77)	(115)
Profit before tax	319	742
Taxation	(5)	(25)
Profit after tax	314	717
Gain on disposal	4,024	-
Taxation on gain on disposal	213	-
Gain on disposal	4,237	-
Total	4,551	717

In 2017/18, a profit of £17 million is reported in discontinued operations, which relates to the reversal of provisions in respect business restructuring costs following the sale of the Gas Distribution business.

Corporate Governance

Corporate Governance Statement

National Grid Gas aims to achieve high standards of leadership and governance. At the National Grid plc level, its Board considers that it complied in full with the provisions of the UK Corporate Governance Code 2016 (the Code) during the year being reported on. National Grid Gas is not required to comply with the Code; however, the Board is mindful of the principles of the Code and develops its governance and oversight of the Company considering not only its ultimate shareholder, National Grid, but the wider range of stakeholders in its business. The Corporate Governance Statement sets out the principal areas of National Grid Gas Board governance together with an explanation of areas where it considers that it has operated consistently with the main principles of the Code.

Governance framework

The Board of the Company is collectively responsible for its governance, and oversees its effective oversight of the Company and its businesses, and compliance with all relevant laws and regulations, including compliance with its obligations under its Gas Transporter Licences. To facilitate this, a comprehensive governance framework has been established. This governance framework forms part of the wider National Grid plc governance framework and is aligned, as required and is applicable, to the Company. Risk management is fundamental to delivering the long term success of the Company and for that reason a separate section of this Annual Report and Accounts has been dedicated to describing our internal controls and risk management, see page 16. The day-to-day operational and financial management of the Company's businesses is undertaken by committees. The committees are operated in compliance with business separation obligations set out in its licenses.

Reinforcing its commitment to sound corporate governance the Board has continued to strengthen and develop both its composition and governance framework, implementing, as applicable, many of the best practice governance principles in operation at the National Grid plc level.

Board composition

The Board consists of six executive directors and two Sufficiently Independent Directors ("SIDs") who between them provide a broad and diverse range of experience and technical skills from both within and external to the organisation, from the energy sector, other regulated industries and external bodies. This depth and breadth of experience, and the independence brought by the SIDs, enables the Board to engage in constructive and challenging discussions, considering the perspectives and interests not only of the Company's shareholder but the wider range of stakeholders in the business. Details of the director positions, demonstrating their area of responsibility within the business, can be found under the section "How our Board operates".

During the last financial year the Board consolidated its composition under the leadership of the Executive Director, UK, Nicola Shaw CBE, who became Chairman of the Board in July 2016. Nicola continues to sit as an Executive Director on the National Grid plc Board. Through her participation at the Boards of both companies, the Board of National Grid Gas is well placed to identify and facilitate understanding of the views of its ultimate shareholder.

Sufficiently Independent Directors

The appointment of two Sufficiently Independent Directors (SIDs) in April 2014 has provided the Board with independent challenge and input to the decision making process. The SIDs bring to the Board a wealth of experience and knowledge derived from working in other businesses in the utility sector, government and regulatory organisations and other businesses and organisations outside of the energy sector. Dr Catherine Bell and Dr Clive Elphick have remained in these roles providing continuity, and an independent voice in the boardroom, during a period of internal change. Their input and involvement in developing the governance framework is demonstrated through their leadership of two committees of the Board: the Audit Committee and Business Separation Compliance Committee. Within the boardroom, the constructive independent challenge and input brought by the SIDs, supports the Board in considering the wider range of stakeholders in the business. Outside of the boardroom, the SIDs hold an annual meeting with the Chief Executive Officer of National Grid plc, enabling them to strengthen their, and the Board's, engagement and understanding of the views of the shareholder. Additionally, in their roles as members of the Company's Audit Committee, the SIDs hold an annual meeting with the Chair of the National Grid plc Audit Committee creating a formal information flow between the independent directors of the two committees.

The SIDs attend a range of site and operational visits and briefing sessions throughout the year, enabling them to strengthen their knowledge and understanding of the business and current operational matters. These visits and briefing sessions also provide the opportunity to create further links between the business and the Board room.

Executive Directors

The executive director membership of the Board consists of the senior managers of the gas transmission and system operator businesses, regulatory function and financial function.

During the year the Board's executive director composition changed as a result of Cordi O'Hara, Director of UK System Operator, starting a new role in the National Grid Group's US business. Phil Sheppard was appointed to the role of Interim Director of UK System Operator and was appointed to the Board in July 2017. Fintan Slye was appointed Director of UK

System Operator and a director of the Board in February 2018. Phil Sheppard continued his directorship on the Board and was appointed Director Gas Transmission Owner in March 2018 following the resignation of Pauline Walsh.

Following the year end, Andy Agg, Group Tax & Treasury Director, resigned from the Board following his acceptance of a new role within National Grid Ventures. Alexandra Lewis, Group Treasurer, was appointed to the Board in April 2018.

All Board appointments are made in consultation with its shareholder and in accordance with National Grid's Procedure for the Appointment of Directors to Subsidiary Companies

Director induction and development

Director training on the statutory duties and responsibilities of directors has been made available to new and existing directors and reference material has been placed in the online document library.

Continuing director training and development is delivered both within and outside of the boardroom. A programme of head office and operational site visits, briefings and internal conferences and events aims to strengthen and refresh the Board's knowledge and understanding of the Company's operations, the external business and regulatory environment and specific technical briefings to support the directors in fulfilling their roles on both the Board and Board Committees. The visits and briefings provide an opportunity for the directors to support and reinforce the Company's culture, values and ethics and promote a culture of openness between Board members and employees and add depth and knowledge to the discussions in the boardroom.

Within the boardroom, the Board receive updates and presentations on current operational matters and specific initiatives within the business and wider National Grid group. These presentations also provide an opportunity for the individual executive directors to benefit from the input of other Board members on matters within their area of the business.

How our Board operates

The Board maintains a schedule of matters specifically reserved for its consideration and decision. This is aligned, as appropriate, to that of the National Grid plc board with additional responsibilities as required by licence obligations. The matters reserved cover matters categorised as: Strategy, Management and Finance, Director and Employee Issues, Corporate Governance, Financial and Regulatory Reporting and Shareholders and includes oversight of the relationship with the regulatory bodies, including Ofgem, Department for Business, Energy and Industrial Strategy and the Health and Safety Executive.

To support the Board, there is an established framework of Committees, to which the Board delegates defined duties under Terms of Reference and within a framework of Delegations of Authority. Further detail on the work of the Committees can be found below.

The Board's accountability for financial and business reporting and risk management and internal control is undertaken within the wider Group governance framework and processes. As a regulated entity, the Board has responsibility for the annual regulatory accounts to which it applies the same rigorous governance processes as that of the statutory accounts, and it involves the work of the Audit Committee. Reporting on the regulatory regime is overseen by the Board, and further detail can be found in the section "What we do – Regulation".

Board meetings are scheduled and communicated a minimum of one year in advance providing all directors with sufficient notice to attend meetings. The matters to be considered throughout the annual board meeting schedule fulfil the Board's responsibilities in line with its statutory duties, licence obligations, its matters reserved for the Board and its authority under the Group Delegations of Authority from National Grid plc. The Board's supervision of the Company's operations is fulfilled through standing agenda items on safety matters, business overviews from the transmission owner and system operator and financial performance. The Board's consideration of health and safety matters covers all parts of the operational business and takes into account the health and safety of employees. Throughout the year, the Board has allocated additional time to focus on the potential impact that the Company's operations may have on the health and safety of members of the public. In addition to this the Board receives a suite of management reports, in line with Group reporting, providing updates on different aspects of the business.

In its steering role, providing leadership to the business, the Board receive papers requesting their input and decision on matters, aligned to the matters reserved to it. The Board regularly reviews the annual business schedule, and amends this to take account of changes in the external and internal environment, enabling it to provide effective, time appropriate leadership and oversight of matters affecting the business.

To enable the Board to be effective and efficient within the boardroom a number of procedures have been established: papers supporting each agenda item are distributed in advance, typically a week before the meeting; training and briefings on specific matters are scheduled prior to the board meeting; and the Chairman holds a short meeting with the SIDs, before each meeting to discuss the focus of the upcoming meeting. After each meeting the Chairman and SIDs meet to share feedback and discuss the dynamics of the meeting, enabling a process of continuous improvement for the operation of future board meetings.

Board performance evaluation

Following the externally facilitated board evaluation in June 2015 (the "2015 Evaluation") progress against the actions has continued, developing and enhancing the performance of the Board. The Board has undertaken an evaluation process during February and March 2018, led by Nicola Shaw in her role as Chair of the Board. The process built on the 2015 Evaluation and focused on three key topics: the Board's effectiveness; the coverage of the Board at its meetings; and change management in key strategic areas over the next three to five years. The evaluation process consisted of a structured questionnaire and one-to-one interviews between the Chair and each director. The Board plans to review the results of the evaluation process later in 2018 before agreeing an agreed action plan aimed to further develop and enhance performance of the Board.

Board membership and attendance

Six Board meetings were scheduled and held during the last financial year. Board membership and attendance at the meetings is set out below. Attendance is expressed as the number of meetings attended out of the number possible or applicable for the individual Director during the year to 31 March 2018.

		Attendance
Nicola Shaw CBE (Chair)	Executive Director UK	6 of 6
Andy Agg[1]	Group Tax & Treasury Director	5 of 6
Alan Foster	UK CFO	5 of 6
Pauline Walsh[2]	Director Gas Transmission Owner	5 of 5
Cordi O'Hara[3]	Director of UK System Operator	1 of 1
Fintan Slye[4]	Director of UK System Operator	1 of 1
Phil Sheppard[5]	Director Gas Transmission Owner	5 of 5
Chris Bennett	Director UK Regulation	6 of 6
Catherine Bell	Sufficiently Independent Director	6 of 6
Clive Elphick	Sufficiently Independent Director	6 of 6

1 Resigned 13 April 2018
2 Resigned 9 March 2018
3 Resigned 16 July 2017
4 Appointed 7 February 2018
5 Appointed 17 July 2017

For those meetings where an executive Director was unable to attend, alternative arrangements were put in place to ensure the Board had representation from the relevant functional area. This was either through the attendance of a senior manager from within the applicable functional area or a written briefing provided by the Director to the Chairman.

Board remuneration

The Directors of the Company are not separately remunerated in that capacity with the exception of the SIDs. The remuneration of any Director who is also a member of the Board of National Grid, is determined by the Remuneration Committee of the Board of National Grid, as set out in its annual report and accounts. The remuneration of other Directors is determined in accordance with National Grid's remuneration policies for employees. As required by Section 33f of the Gas Act 1986, the Company has provided to Ofgem details of the linkages between Directors' remuneration and service standards.

Committees

The Board has established a number of committees and sub-committees which assist it in its activities and operate within agreed Terms of Reference and a framework of Delegations of Authority. The Committees of the Board are listed below:

- Gas Transmission Executive Committee
- System Operator Executive Committee
- Business Separation Compliance Committee
- Finance Committee
- Audit Committee

The Company does not have a Nominations or Remuneration Committee as these functions are provided by National Grid plc. See the Annual Report and Accounts of National Grid plc for further information about these committees.

Gas Transmission Executive Committee

The purpose of the Gas Transmission Executive Committee (GTEC) is to direct the affairs of the Gas Transmission Owner business on behalf of its Board and to perform an assurance role within the context of the overall RIIO networks governance framework and oversee the performance of any sub-committees reporting to it. The Committee's remit extends to approving the Gas Transmission strategies and business objectives for managing the RIIO contract and for approving opportunities to deliver value within that contract in accordance with published Delegation of Authority (DoA) limits.

Additionally the Committee performs assurance responsibilities for the Gas Transmission Owner business performance frameworks including the monitoring of performance against the RIIO contract, financial targets, high-level risks and audit outcomes. To this end the Committee receives summary reports from Process Performance Meetings, Regulatory Commercial Committees and Business Partner Functions.

GTEC acts within National Grid's overall corporate governance framework and delegated authorities and is responsible for the operational and financial management of the Gas Transmission Owner business. Membership of this Committee comprises at least two Directors of the Company, senior managers of the Gas Transmission Owner business and certain other senior managers. Attendance of the voting members is expressed as the number of meetings attended out of the number eligible to attend, and includes attendance by a nominated deputy during the year to 31 March 2018. There were 12 Committee meetings held during the year.

		Attendance
Pauline Walsh[1]	Director, Gas Transmission Owner	10 of 11
Phil Sheppard[2]	Director, Gas Transmission Owner	1 of 1
Isabelle Haigh	Head of GTO Business Change and Optimisation	11 of 12
Mark Lissimore	Head of GTO Operations	11 of 12
Karl Yates	Head of GTO Delivery Services	11 of 12
David Salisbury[3]	Head of Network Engineering	5 of 6
Tony Nixon[4]	Head of Network Engineering	4 of 4
Tony Green[5]	Head of Network Engineering	2 of 2
Ian Radley	Head of Gas Construction	11 of 12
Andy Malins	Head of Network Capability & Operations, Gas	11 of 12
Chris Bennett	Director, UK Regulation	8 of 12
Vicki Findall[6]	Lead Finance Business Partner, GTO	4 of 5
Dean Sutton[7]	Lead Finance Business Partner, GTO	7 of 7

1. Resigned March 2018
2. Appointed March 2018
3. Resigned September 2017
4. Appointed October 2017, Resigned February 2018
5. Appointed February 2018
6. Resigned September 2017
7. Appointed September 2017

The GTEC has a number of sub-committees dealing with matters such as investment, governance, safety and coordination of operations.

System Operator Executive Committee

The System Operator Executive Committee (SOEC) acts within National Grid's overall corporate governance framework and delegated authorities and is responsible for the strategic direction of Great Britain SO activities (Gas and Electricity combined) and RIIO incentive and output performance measures. The SOEC was set up following the implementation of the new UK Operating Model in 2013. Membership of this Committee comprises Directors of the Company, senior managers of the Transmission business and certain other senior managers. Attendance of the voting members is set out below and is expressed as the number of meetings attended out of the number eligible to attend, and includes attendance by a nominated deputy during the year to 31 March 2018. There were three Committee meetings held during the year.

		Attendance
Cordi O'Hara	Director of UK System Operator	2 of 2
Phil Sheppard	Interim Director of UK System Operator	1 of 1
Duncan Burt	Director of SO Operations	1 of 1
Darren Pettifer	SO Finance Business Partner	2 of 2
Claire Tuckman	SO Finance Business Partner	1 of 1
Chris Bennett	Director UK Regulation	3 of 3
Simon Johnston	Head of Business Change	2 of 3
Roisin Quinn	Head of SO Strategy	2 of 3

The SOEC has a number of sub-committees dealing with matters such as SO specific investments, SO Risk and Compliance and SO Incentive Performance.

Business Separation Compliance Committees

The Business Separation Compliance Committee of the Board is responsible for overseeing the duties and tasks of the Business Separation Compliance Officer and for overseeing compliance with the business separation licence conditions.

Membership of the Committee is by appointment of the Board and comprises all directors of the licensee. The Committee is chaired by Dr Catherine Bell, SID, providing independent leadership of the Committee. The Business Separation Compliance Officer/Compliance Officer are in attendance and present reports on their duties, activities and compliance with the licence obligations.

Two Committee meetings were held during the year, with additional meetings taking place between the Chairman of the Committee and the Business Separation Compliance Officer/Compliance Officer. Following the meetings, the Chairman provided updates to the Board on matters considered at the meetings.

Finance Committee

The Finance Committee of the Board is responsible for setting policy and grants authority for financing decisions, credit exposure, hedging and foreign exchange transactions, guarantees and indemnities subject to the risk appetite of the Board. It also approves, other treasury, tax, pension funding and insurance strategies, and if appropriate, recommends them to the Board. During the year, the Company's Pensions Committee was disbanded and the Finance Committee's remit was extended to also provide governance of the Company's pension schemes.

Membership of the committee comprises the Finance Director of National Grid plc and the Group Tax and Treasury Director, a director of the Board. The Committee interfaces with the Finance Committee of National Grid plc and the Board.

Each Board meeting considers a separate agenda item on the work of the Finance Committee. Financial reporting on the financing activities, taxation and financial costs and liabilities of the pension schemes is provided through the regular financial management reports discussed at each board meeting.

Audit Committee

The Audit Committee's role is to keep the Company's financial reporting and the effectiveness of its internal controls under review, together with its risk management processes. It also reviews the external audit plan and the external auditors' findings.

Membership of this Committee is comprised of three Board directors: the two SIDs and an executive director, the Group Tax and Treasury Director. The Committee is chaired by Dr Clive Elphick, SID, providing independent leadership. Financial experience is provided by both Clive and the Group Tax and

Treasury Director. In addition to the members of the Committee, individuals such as representatives of the external auditors, Head of UK Audit, representatives of the Assurance function, UK Chief Financial Officer and other representatives of the finance function and the UK General Counsel and Company Secretary may be invited to attend by the Committee and normally attend each meeting. Other Directors, representatives of the business and external advisors may be invited to attend as and when considered appropriate by the Committee and in respect of items that are relevant to them.

Since its inception in November 2014, the Audit Committee's role has been developed and enhanced, providing the assurance required by the Board on matters within its authority. The Chairman provides a report on each meeting to the following Board meeting, and where applicable makes recommendations to the Board. The Board considers these recommendations and, where required, seeks further assurance and details to be brought to the Board.

To strengthen the governance links to National Grid, the SIDs hold an annual meeting with the Chairman of the National Grid plc Audit Committee.

The preparation and management of the Audit Committee's annual meeting schedule follows the same governance processes as those for the Board. Technical briefings and meetings with the UK Chief Financial Officer and members of the financial function are held before meetings, as required, to provide further details on matters to be discussed during the meetings.

Five meetings took place during the last financial year. Committee membership and attendance at meetings is set out below. Attendance is expressed as the number of meetings attended out of the number possible or applicable for the individual Director during the year to 31 March 2018.

		Attendance
Clive Elphick (Chair)	Sufficiently Independent Director	5 of 5
Catherine Bell	Sufficiently Independent Director	5 of 5
Andy Agg	Group Tax and Treasury Director	5 of 5

Following the year end, Andy Agg resigned as director of the Board and was replaced by Alexandra Lewis, Group Treasurer; it followed that Alexandra also replaced Andy as a member of the Audit Committee at the same time.

Areas of focus

The Audit Committee meetings considered a programme of matters comprising those which were aligned to that of the National Grid plc Audit Committee and specific matters as they related to the Company, as a listed and regulated entity and as defined in the Terms of Reference for the Committee. Examples of key areas of focus included:

- Statutory and regulatory accounting statements
- Going concern statements
- Fair, balanced and understandable statements
- Financial reporting
- Internal controls and processes
- Regulatory to RIIO accounts transition
- Risk management processes
- Compliance matters, including compliance with licence obligations
- Internal (corporate) audit plan
- Business conduct, including whistleblowing

Significant issues

The most significant issues the Committee considered during the year were matters relating to internal controls and processes, compliance and judgements made in the preparation of the year-end financial statements, including assumptions used in the calculation of provisions and pension liabilities.

Looking forward, the Committee will continue to focus on the effectiveness of the internal control environment, providing input to the Group wide process.

In terms of financial reporting changes, the Committee will continue to focus on the changes in the regulatory accounting reporting for the implementation of RIIO accounts.

External audit

The Committee is responsible for overseeing relations with the external auditors, as part of the Group wide external audit arrangements. Each Committee meeting is preceded by a meeting between the SIDs and the external auditor, without management present, to allow independent discussions on any matters the auditors would like to bring to the attention of the Committee.

The Committee reviews the audit plan and audit findings in respect of the audit of the statutory and regulatory accounts. The Committee also engages on auditor recommendations for improvements around internal controls. Through regular management reporting on internal controls, the Committee is able to monitor progress of the actions being taken.

Following the National Grid plc Audit Committee audit tender process, Deloitte LLP was appointed by shareholders as the Group's statutory auditors at the AGM in July 2017.

Auditor transition

Deloitte's transition plan focused on developing a deeper understanding of the Company's business, processes and control, and leveraging the experience and knowledge of PricewaterhouseCoopers (PwC) during the shadowing period. Deloitte shadowed PwC during 2016/17 year end close process and attended Audit Committee meetings in June and July 2017. They also undertook a review of the PwC audit files and held meetings with key management. The Committee received regular updates on the status of the transition during the year.

Internal (corporate) audit
The Company does not have a separate internal audit team. This function is provided by National Grid's Corporate Audit function which provides independent and objective assurance to the National Grid Gas Audit Committee, Safety, Environment and Health Committee (SEH) and Executive Committees on whether our existing control and governance frameworks are operating effectively in order to meet National Grid's strategic objectives. Assurance work is conducted and managed in accordance with the IIA international standards for the Professional Practice of Internal Auditing and Code of Ethics.

Inputs to the audit plan include principal risks, risk registers, corporate priorities, and external research of emerging risks and trends, and discussions with senior management to make sure the plan aligns with the Committee and Company's view of risk. The audit plan is considered and approved by the Committee annually and progress against the plan is monitored throughout the year.

The Committee receive regular controls updates from the Corporate Audit team. Management actions on audit findings have continued to be a focus at Executive meetings resulting in greater visibility of audit findings, increased ownership of actions and greater engagement by senior management.

Auditors' independence and objectivity
Mindset, integrity and objectivity enable auditors to undertake their role with professional scepticism while maintaining effective working relationships with those subject to audit i.e. management and other employees.

As highlighted in National Grid's Annual Report and Accounts for 2017/18 the independence of the external auditors is essential to the provision of an objective opinion on the true and fair view presented in the financial statements.

Following consideration of the auditors' independence and objectivity, the audit quality and the auditors' performance, the Committee was satisfied with the effectiveness, independence and objectivity of Deloitte and recommended to the Board their reappointment for the year ended 31 March 2019. A resolution to re-appoint Deloitte and giving authority to the Directors to determine their remuneration will be submitted to shareholders at the 2018 AGM.

Directors' Report

The Directors present their report and the audited consolidated financial statements of the Group for the year ended 31 March 2018. In accordance with the requirements of the Companies Act 2006, the following sections describe the matters that are required for inclusion in the Directors' Report and were approved by the Board. Further details of matters required to be included in the Directors' Report are incorporated by reference into this report, as detailed below.

Directors

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

Andy Agg	Resigned 13 April 2018
Catherine Bell CB (SID)*	
Chris Bennett	
Clive Elphick (SID)*	
Alan Foster	
Alexandra Lewis	Appointed 13 April 2018
Cordi O'Hara	Resigned 16 July 2017
Nicola Shaw CBE	
Phil Sheppard	Appointed 17 July 2017
Fintan Slye	Appointed 7 February 2018
Pauline Walsh	Resigned 9 March 2018

*Sufficiently Independent Director

The Company has arranged, in accordance with the Companies Act 2006 and the Articles, qualifying third party indemnities against financial exposure that Directors may incur in the course of their professional duties. Equivalent qualifying third party indemnities were, and remain, in force for the benefit of those Directors who stood down from the Board during the year ended 31 March 2018. Alongside these indemnities, the Company places Directors' and Officers' liability insurance cover for each Director.

Principal activities and business review

A full description of the Company's principal activities, businesses, key performance indicators and principal risks and uncertainties is contained in the Strategic Report on pages 10 to 15, which are incorporated by reference into this report.

Material interests in shares

National Grid Gas plc is a wholly owned subsidiary undertaking of National Grid Gas Holdings Limited. The ultimate parent company of National Grid Gas plc is National Grid plc.

Dividends

During the year, no interim dividend was paid (2016/17: £8,100 million interim dividend). The Directors have not proposed a final dividend.

Share capital

Share capital remains unchanged. See note 21 to the consolidated financial statement for further details.

Research and development

Expenditure on research and development was £4 million during the year (2016/17: £4 million).

Financial instruments

Details on the use of financial instruments and financial risk management are included in note 25 to the consolidated financial statements.

Future developments

Details of future developments are contained in the Strategic Report.

Employee involvement

Details of how the Company involves its employees are contained in the Strategic Report on pages 10 and 15, which are incorporated by reference into this report.

Audit information

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

Annual General Meeting

Notice of the National Grid Gas's Annual General Meeting for 2018 will be issued separately to the shareholder.

Going concern

Having made enquiries and reviewed management's assessment of the going concern assumption, the Directors consider it appropriate to prepare the financial statements on a going concern basis. The going concern basis presumes that the Company has adequate resources to remain in operation, and that the Directors intend it to do so, for at least one year from the date the financial statements are signed. More detail on our financial risks, including liquidity and solvency, is provided in note 25 to the consolidated financial statements. There have been no major changes to the liquidity and solvency risks in the year. Although not assessed over the same period, the viability has been assessed on page 20.

On behalf of the Board

Alan Foster
UK CFO
21 June 2018
National Grid Gas plc,
1-3 Strand, London WC2N 5EH
Registered in England and Wales Number 2006000

Introduction to the financial statements

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

Notes

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

Statement of Directors' responsibilities

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland". Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

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

- Select suitable accounting policies and then apply the consistently;
- Make judgements and accounting estimates that are reasonable and prudent;
- State whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

In preparing the financial statements, International accounting Standard 1 requires that directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the company's ability to continue as a going concern.

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

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

On behalf of the Board

Alan Foster
UK CFO
21 June 2018

Independent Auditors' report

to the Members of National Grid Gas plc

Report on the financial statements

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2018 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and IFRSs as issued by the International Accounting Standards Board (IASB);
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"; 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.

We have audited the financial statements of National Grid Gas plc (the 'parent company') and its subsidiaries (the 'group') which comprise:

- the consolidated income statement;
- the consolidated statement of comprehensive income;
- the consolidated statement of changes in equity;
- the consolidated statement of financial position;
- the consolidated cash flow statement;
- the related notes 1 to 28 of the consolidated financial statements;
- the Company accounting policies;
- the Company balance sheet;
- the Company statement of changes in equity; and
- the related notes 1 to 17 of the Company financial statements.

The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

Basis of our opinion

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

We are independent of the group and the parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Summary of our audit approach

Key audit matters	The key audit matters that we have identified in the current year were: • the internal control refresh programme; • IT user access management controls; • net pension obligations; • revenue recognition; • classification of capital costs; and • treasury derivative transactions.
Materiality	The materiality that we used for the group financial statements was £24.2 million based on 5% of profit before tax.
Scoping	We focused our group audit scope on the parent company, which accounts for 99% of the group's revenue and 98% of the group's profit before tax and net assets
First year audit transition	The year ended 31 March 2018 is our first as auditor of the group. We have been independent since 1 January 2017 and commenced our transition from that date. The transition included: • establishing a detailed audit transition plan; • shadowing the previous auditor through the 31 March 2017 audit, including attendance at key meetings; • holding transition workshops with finance and operational management, Internal Audit, the treasury function, the pensions, tax and legal teams in order to inform our audit planning; • reviewing the previous auditor's audit file; and • reviewing historic accounting policies and accounting judgements through discussion with management and review and challenge of management's papers and supporting documentation. This process built our understanding of the group which informed our risk assessment process, from which we identified the risks of material misstatement to the group's financial statements. We presented our audit plan and transition observations to the group's senior management and to the Audit Committee throughout the transition process, including in a transition report and audit plan presented in September 2017 and updates to our audit plan in November 2017 and March 2018.

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where: • the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or • the directors have not disclosed in the financial statements any identified material uncertainties that may cast doubt about the group's or the parent company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.	**We have nothing to report in respect of these matters.**

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

Throughout the course of our audit we identify risks of material misstatement ("risks") and classify those risks according to their severity. In assigning a category we consider both the likelihood of a risk of a material misstatement and the potential magnitude of a misstatement in making the assessment. Certain risks are classified as "significant" or "higher" depending on their severity. The category of the risk determines the level of evidence we seek in providing assurance that the associated financial statement item is not materially misstated.

We have described herein the risk categorisation assigned to each of our key audit matters and the reasoning behind that judgement.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Internal control refresh programme

Key audit matter description

Throughout the period the group has undertaken a refresh of its internal control over financial reporting framework including the scoping, risk assessment, process and design of control documentation, and the evaluation and testing of controls ("the refresh programme")

As a result of the programme undertaken by management a significant focus has been placed on the understanding of the group's processes and the assessment of the design, implementation and operating effectiveness of the group's internal control framework.

The assessment of the group's control framework is a key part of our audit and core to the group's ability to maintain financial records, prepare financial statements in accordance with IFRS and, where material, prevent or detect unauthorised acquisition, use or disposition of the group's assets. In particular, in the current period, the refresh programme has meant that the control environment has evolved through the period and accordingly has required additional resource to perform procedures on new or enhanced controls as they are designed and implemented by the group.

The internal control refresh programme is pervasive to the group's operations and accordingly the level of risk ascribed to our work in this area is dependent on the nature and complexity of the control itself and the balance or balances within the financial statements to which the control relates.

Refer additionally to the Strategic Report on page 16.

How the scope of our audit responded to the key audit matter

In performing our assessment of the group's control environment we have performed a number of procedures, including:

- detailed walkthroughs of the processes associated with each of the group's key business cycles including financial reporting, revenue, purchase-to-pay, order-to-cash and property, plant and equipment;
- identification of the audit risks impacted by a change in process or control during the period;
- testing of relevant controls where the control has changed in the period following the refresh programme;
- identifying reports and other information used in the operation of relevant controls and performing appropriate procedures to determine their accuracy and completeness;
- identifying relevant IT applications, infrastructure and operating systems used in the operation of the group's relevant controls and performing testing of the general IT controls over those systems, including the use of our automated controls testing tool; and
- where deficiencies in internal control were identified testing compensating controls or performing alternative procedures, including modifying our audit approach, where appropriate.

Key observations

We identified weaknesses relating to user access controls over some IT systems, which could have had a negative impact on other controls by allowing unauthorised access to the financial reporting systems. As a result of our findings we identified a further key audit matter in relation to IT user access management controls discussed below.

IT user access management controls

Key audit matter description

Due to the reliance on IT systems within the group, controls over access rights are critical to maintaining an effective control environment. As a result of our procedures over internal control we identified a number of deficiencies relating to segregation of duties, control over privileged access and user access management both within the group and the group's IT service organisations (together "access deficiencies"). The deficiencies identified increase the risk that individuals within the group and at service organisations had inappropriate access during the period. The existence of deficiencies during the year and at the year end result in an increased risk that data and reports from the affected systems are not reliable.

The group put in place a programme of activities to remediate the deficiencies during the year which is on-going at year end.

The IT user access management controls are pervasive to the group's operations and accordingly the level of risk ascribed to our work in this area is dependent on the nature and complexity of the control itself and balances within the financial statements the control addresses.

Refer additionally to the Strategic Report on page 16.

How the scope of our audit responded to the key audit matter	In responding to the identified deficiencies in user access we have: • obtained and reviewed reports on the internal controls implemented and operated by relevant service organisations and, where necessary directly tested certain third party controls or identified business controls that do not rely on information that is potentially affected by the IT access management controls which mitigate reported control issues; • determined the impact that utilising inappropriate levels of access could feasibly have had on the affected systems including assessing the likelihood of inappropriate user access impacting the financial statements, and testing controls implemented by management to identify instances of the use of inappropriate access; and • identified and tested alternative or compensating controls where such controls existed within the group's control framework or where no such controls existed extended the scope our audit such that we have not placed reliance on controls for information produced or held in the impacted systems, including expanding the scope of our substantive testing.
Key observations	We confirmed that the mitigating business controls address the risk of a material misstatement to the financial statements. Furthermore we conducted a largely substantive audit and only continued to rely on revenue and environmental provisions controls.

Net pension obligations

Key audit matter description	Substantially all of the group's employees are members of one of a number of pension schemes. These pension schemes include both defined benefit and defined contribution schemes. We have identified a key audit matter specifically in relation to the assumptions used in the valuations of the defined benefit schemes which as at 31 March 2018 represent an obligation of £5.3 billion and scheme assets of £5.7 billion. The key judgements relating to the pension obligations include inflation assumptions, discount rates, mortality assumptions and future salary changes applied to active members. The setting of these assumptions is complex and changes to these assumptions can have a material impact on the value of pension liabilities. The pension schemes also include a number of "level 3" assets, being those assets which do not have market-observable inputs, to use in calculating their fair value. As such there is significant judgement in determining the fair value of these assets including the selection of the valuation methodology and other key assumptions. We have identified the discount rates applied to net pension obligations as a 'significant' risk within our audit plan due to the sensitivity of the balance to changes in the rate and the level of estimation uncertainty and judgement involved in determining the level of liability. We have assessed other areas of the net pension obligations to be 'higher' or 'lower risk' in our audit plan. We additionally note that during the year there has been a change in the specialist actuaries used by the group to calculate net pension obligations. Refer additionally to note 19 for further discussion on the Group's net pension obligations.
How the scope of our audit responded to the key audit matter	We have tested the operating effectiveness of controls over the pension assets and liabilities. We have engaged our actuarial experts to assist in testing of the discount rate used in calculating the pension liabilities. We have independently calculated an appropriate discount rate and compared this to management's rate. We have performed a sensitivity analysis of the pension liabilities using our independently calculated rate. Further, our actuarial experts have assisted us in benchmarking and challenging the other assumptions used by management in determining the value of pension liabilities particularly focusing on inflation, salary growth and mortality rates; this has included comparing the inputs and assumptions used in determining the valuation of the group's schemes to those used in comparable pension plans and our internal benchmarks. Additionally, we have considered the independence, objectivity and competence of the independent actuaries engaged by management to perform valuations of the relevant schemes.

	We have performed audit procedures relating to the assets held within the pension schemes through seeking third party confirmation from asset managers and/or custodians or other supporting evidence as appropriate. Additionally, we have engaged internal specialists to challenge the valuation of scheme assets, in particular the "level 3" assets. Our work has included reviewing publically available information on these assets, comparing to internal benchmarks and reconciliation of inputs used by management to determine the asset values.
Key observations	We judge the discount rate and other key pension assumptions used by management to be in the middle of our internally developed reasonable range.
Revenue recognition	
Key audit matter description	In the year to 31 March 2018 the group has recognised revenue of £1.4 billion (31 March 2017: £1.3 billion). We have identified aspects of revenue recognition as 'higher' risks in our audit plan and we have rebutted the presumption set out in Auditing Standards that there is a significant risk of fraud in revenue recognition given the nature of the group's primary revenue streams. As the first year of our audit tenure however, significant resource has been invested in understanding the regulatory environment and methodologies used and this has led us to identify revenue recognition as a key audit matter. Revenue has historically been predictable, which is a function of both the nature of the business and the regulatory price controls. The group is a transmission owner and operator and operates in a highly regulated market. Accordingly there is little judgement with regard to revenue recognition. Refer additionally to note 1 (a).
How the scope of our audit responded to the key audit matter	We have tested the effectiveness of controls over revenue recognition including the controls over the calculation of accrued income. We have developed analytical tools designed to use third party data and known regulatory prices to recalculate the group's revenue for the period. We have tested whether the amounts charged to customers are consistent with the rates which are set by the group's regulators.
Key observations	On the basis of the procedures performed we are satisfied that the group has recognised revenue in accordance with its policy and IAS 18 Revenue.
Classification of capital costs	
Key audit matter description	The group has an extensive capital investment programme with capital expenditure totalling £0.3 billion. Judgement is required to determine whether certain activities should be treated as operating expenditure (maintenance or network repair) or capital expenditure (additions of or enhancement to network assets). The group has significant experience in determining the classification of expenditure as operating cost or capital expenditure. We do not consider this to be a significant risk for our audit. We have however identified the accuracy of capital expenditure as a 'higher' risk within our audit plan as there is judgement in classifying expenditure albeit the level of judgement is not as significant as in other areas of the financial statements. Due to the magnitude and significance of the asset base to the group's operations we do consider it to be a key audit matter requiring the allocation of significant audit resource. Refer to note 9 for further discussion of the Group's capital expenditure.
How the scope of our audit responded to the key audit matter	We have tested effectiveness of controls, over the classification of expenditure and the transfer between assets in the course of construction and property plant and equipment. We have tested an audit sample of additions to assets that are classified as assets under construction and validated their classification as capital expenditure.
Key observations	The results of our procedures were satisfactory and on the basis of these procedures we conclude that the capital expenditure recorded is appropriate.

Treasury derivative transactions	
Key audit matter description	At 31 March 2018 the group had total borrowings of £5.0 billion (31 March 2017: £5.5 billion). The group mitigates the exposure to interest rate and foreign exchange rate risks with risk management activities including the use of derivatives such as cross-currency and variable interest rate swaps. The group designates derivatives in hedge relationships where possible. The valuation of the derivative portfolio requires management to make certain assumptions and judgments in particular around the valuation methodologies adopted and the discount rate to be applied to forecast cash flows. The portfolio also includes "level 3" derivatives for which no directly observable inputs for their fair value are available (such as a quoted market price). Accordingly there is judgement involved in determining the methodology used to fair value these derivatives. We have identified the accuracy and valuation of certain treasury derivatives as a 'higher' risk within our audit plan due to the level of judgement and the technical nature of determining derivative values. We have also identified certain of the hedge accounting requirements adopted for certain of the group's derivative financial instruments as a 'higher' risk. Refer additionally to notes 11 and 25 to the financial statements for further details on derivatives.
How the scope of our audit responded to the key audit matter	We have tested the design, implementation and operating effectiveness of controls over the recording and valuation of derivative financial instruments. This has included testing of the review-type controls performed by management over the valuations and challenge of the estimates made. In conjunction with our treasury specialists we have tested a sample of the models used by management, including a challenge of the assumptions therein, to confirm the appropriateness of the valuation methodology adopted and the assumptions applied. Where relevant we have obtained third party confirmations to test the completeness and accuracy of the information held within the group's treasury management system. We have analysed the hedge effectiveness testing performed by management and tested the disclosure within the financial statements. In the performance of our testing we have considered the requirements of IAS 39 Financial Instruments: Recognition and Measurement to determine whether the appropriate accounting treatment has been adopted by the group.
Key observations	The results of our procedures were satisfactory and on the basis of these procedures we conclude that the accounting for derivatives, including the group's use of hedge accounting, is appropriate.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent company financial statements
Materiality	Materiality has been set at £24.2 million for the current year.	Materiality has been set at £24.1 million for the current year.
Basis for determining materiality	We have set materiality based on 5% of profit before tax.	We have set materiality based on 5% of profit before tax.
Rationale for the benchmark applied	We consider profit before tax to be a critical benchmark of the performance of the group.	We consider profit before tax to be a critical benchmark of the performance of the group.

We set performance materiality for the group at £17 million which represents 70% of our materiality. We use performance materiality to determine the extent of our testing; it is lower than materiality to reflect our assessment of the risk of errors remaining undetected by our sample testing and uncorrected in the financial statements. Performance materiality for the parent company was set at £16.9 million, which represents 70% of our materiality similarly to the performance materiality set for the group.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £1.2 million, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

The group audit was scoped by obtaining an understanding of the group and its environment, including group-wide controls, and assessing the risks of material misstatement at the group level. We focused our group audit scope on the parent company which was subject to a full scope audit and was executed at a component materiality of £24.1 million. This accounts for 99% of the group's revenue and 98% of the group's profit before tax and net assets.

Audit work to address the identified risks of material misstatement was performed directly by the audit engagement team and no component auditors were engaged.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

Responsibilities of directors

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

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

Use of our report

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

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

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

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

In the light of the knowledge and understanding of the group and of the parent company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

We have nothing to report in respect of these matters

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 parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns.

Directors' remuneration

We have nothing to report in respect of these matters

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

Other matters

Auditor tenure

We became independent and commenced our audit transition on 1 January 2017. Following the recommendation of the Audit Committee, we were appointed by the Shareholders at the Annual General Meeting on 31 July 2017 to audit the financial statements for the year ending 31 March 2018. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is accordingly one year.

Consistency of the audit report with the additional report to the audit committee

Our audit opinion is consistent with the additional report to the audit committee we are required to provide in accordance with ISAs (UK).

Jane Whitlock ACA (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
Birmingham, UK
22 June 2018

Basis of preparation

(for National Grid Gas plc)

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 IASB and EU endorsed accounting standards, amendments and interpretations and whether these are effective in 2018 or later years, explaining how significant changes are expected to affect our reported results.

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

These consolidated financial statements were approved for issue by the Board of Directors on 21 June 2018.

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 2018 and in accordance with the Companies Act 2006 applicable to companies reporting under IFRS and Article 4 of the EU IAS Regulation. The comparative financial information has also been prepared on this basis.

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

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

The financial information relating to prior years has been re-presented as a result of the disposal of the UK Gas Distribution business, as described in C below. The notes to the financial statements have been prepared on a continuing basis unless otherwise stated.

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 E).

A. Going concern

The Directors considered it appropriate to prepare the financial statements on a going concern basis. The going concern basis presumes that the Group has adequate resources to remain in operation, and that the Directors intend it to do so, for at least one year from the date the financial statements are signed.

B. Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries. 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.

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

The results of subsidiaries (other than relating to Gas Distribution as described in C below), 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.

C. Disposal of UK Gas Distribution

As described further in note 7, the disposal of the Gas Distribution business completed on 1 October 2016 and as a result all assets and liabilities of UK Gas Distribution were disposed.

As Gas Distribution represented a separate major line of business and accordingly was presented as a discontinued operation in the consolidated income statement, consolidated statement of comprehensive income and the consolidated cash flow statement in 2016/17.

D. 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 see note 11.

E. 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:

- Concerning the sale of UK Gas Distribution – note 7:
- the allocation of financing costs between the continuing Group and discontinued operations; and
- the identification and classification of costs associated with the disposal.
- the categorisation of certain items as exceptional items, and the definition of adjusted earnings – note 3.
- environmental and decommissioning provisions – note 20.

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 and remeasurements. Exceptional items and remeasurements 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.

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

- review of residual lives, carrying values and impairment charges for other intangible assets and property, plant and equipment – notes 8 and 9.
- estimation of asset/liabilities for pensions and other post-retirement benefits – note 19.
- valuation of financial instruments and derivatives – notes 11 and 25.
- revenue recognition and assessment of unbilled revenue – note 1.
- environmental and decommissioning provisions – note 20.

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 26.

Recent accounting developments

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'(IFRS 9), IFRS 15 'Revenue from Contracts with Customers' (IFRS 15) and IFRS 16 'Leases'(IFRS 16). We are assessing the likely impact of these standards on the Group's financial statements.

i) IFRS 15 'Revenue from Contracts with Customers'
IFRS 15 'Revenue from Contracts with Customers' is effective for National Grid Gas plc for the year ending 31 March 2019. The new standard provides enhanced detail and a five step revenue recognition approach to reflect the transfer of goods and services to customers. The core principle of IFRS 15 is that an entity recognises revenue related to the transfer of promised goods or services when control of the goods or services passes to customers.

The amount of revenue recognised should reflect the consideration to which the entity expects to be entitled in exchange for those goods or services. This differs from the principle under the current revenue standard that requires an assessment of when risks and rewards of goods and services are transferred rather than control of those goods or services.

Detailed reviews of revenue arrangements have been undertaken prior to our transition to IFRS 15 on 1 April 2018. We will adopt the modified retrospective approach whereby the historical cumulative transition adjustment is reflected through retained earnings.

There are two types of revenue arrangements that will be impacted on transition to IFRS 15. The financial impacts and the transition adjustment to retained earnings are described further:

- There are certain pass-through revenues, principally amounts collected on a monthly basis from the distribution networks and paid to the pension fund, where the principal/agency assessment changes on transition to IFRS 15. In moving from a risk and reward model to a control model, we will no longer record these amounts collected as revenues, as we do not control amounts collected and paid to the pension fund. If we had adopted IFRS 15 in 2017/18, both revenues and operating costs would have been £66 million lower, with no impact to profit as a result of this change. There will be no resulting transition adjustment as a result of this change; and

- Our customers provide contributions for certain capital works (e.g. connections) which we continue to own on completion of the works. In our Gas Transmission business, we recognise customer contributions when the connection is completed (the contractual conditions of the connection agreement do not explicitly require connections to be maintained over the life of the connection).

Under IFRS 15, connection contributions will be deferred and released into the income statement as revenue over the life of the network. We have reached this conclusion because our customers cannot benefit from a connection without the use of our utility network; access to our network through the connection is satisfied over time.

We also have arrangements where our customers make contributions for diversions. These are currently deferred over the life of our network. Under IFRS 15, these revenues are recognised on completion of the diversion as there are no ongoing performance obligations to satisfy.

Had we adopted IFRS 15 in 2017/18, revenues would have been circa £4 million lower, as revenues from Gas Transmission connections that were previously recognised up-front would have been deferred over the life of the network. Additionally, operating expenses would have been £2 million higher, due to the fact that releases of deferred income in respect of historic diversions would not have been made. Thus the total decrease in profit after tax would have been £6 million.

The transition adjustment through retained earnings of £61 million will result in a decrease to deferred revenues of approximately £76 million and a corresponding deferred tax impact of £15 million.

ii) IFRS 16 'Leases'
IFRS 16 'Leases' is effective for National Grid Gas plc for the year ending 31 March 2020. The company enters into a significant number of operating lease transactions. Under IFRS 16, our operating leases will be accounted for on the balance sheet as 'right-of-use' assets. This treatment will increase both our assets and liabilities and subsequently, will result in an increase in finance costs and depreciation and a reduction in rental costs. The outcome of our conclusions will have an impact on how we account for our operating leases. We are also performing an assessment of our revenue, service contracts and power purchase contracts to determine whether we have the right to use assets under those contracts and whether they fall within the scope of IFRS 16. We plan to apply IFRS 16 using the modified retrospective approach, whereby comparatives will not be restated on adoption of the new standard but instead a cumulative adjustment will be reflected in retained earnings.

iii) IFRS 9 'Financial Instruments'
IFRS 9 'Financial Instruments' (IFRS 9) is effective for National Grid Gas plc in the year ending 31 March 2019. The changes to IFRS 9 principally impact the accounting for the classification of financial instruments, impairment of financial instruments and hedge accounting.

We have elected not to restate comparatives on initial application of IFRS 9. The full impact of adopting IFRS 9 will depend on the financial instruments that the Group has during the year ending 31 March 2019 as well as on economic conditions and judgements made as at the year end. The Group has performed a preliminary assessment of the potential impact of adopting IFRS 9 based on the financial instruments and hedging relationships as at the date of adoption of IFRS 9 (1 April 2018).

Classification and measurement: financial assets
The number of categories of financial assets has been reduced under IFRS 9 compared to IAS 39. Under IFRS 9 the classification of financial assets is based on the business model within which the asset is held and the contractual terms of the asset. There are three principal classification categories for financial assets that are debt instruments: (i) amortised cost, (ii) fair value through other comprehensive income (FVOCI) and (iii) fair value through profit or loss (FVTPL). Equity investments are either classified as (i) FVTPL or (ii) FVOCI. If measured at FVOCI, realised gains on equity investments are not recycled to the income statement but instead are transferred directly to retained profits.

The change to the asset classification rules will have no impact in reported group net assets, although there will be some changes to reserves at transition. These changes are not material.

Classification and measurement: financial liabilities
Under IFRS 9 financial liabilities can be designated at FVTPL to eliminate an accounting mismatch. Where financial liabilities are designated at FVTPL, changes in their fair value due to credit risk are presented in other comprehensive income.

With effect from 1 April 2018 the group has taken the fair value option for one issued zero coupon liability to reduce the measurement mismatch against some derivatives. The effect of this election at transition is the establishment of an own credit reserve of £9m and an overall reduction in reported net assets of c£32m.

Impairment
The impairment model under IFRS 9 reflects expected credit losses, as opposed to only incurred losses under IAS 39. The new impairment model will apply to the group's financial assets that are debt instruments measured at amortised cost or FVOCI as well as the group's trade receivables.

Other investments in debt instruments that are subject to the IFRS 9 impairment model are determined to be low credit risk at 31 March 2018. We intend to apply the low credit risk simplification in IFRS 9 which allows the company to assume that there has not been a significant increase in credit risk since initial recognition of these assets and therefore recognise a loss allowance for only 12-month expected credit losses as at 1 April 2018. The adjustment to the opening reserves in respect of this is not expected to be significant.

Hedge accounting
On initial application of IFRS 9, an entity may choose to continue to apply the hedge accounting requirements of IAS 39 instead of those of IFRS 9. The group has elected to apply the hedge IFRS 9 accounting requirements because they more closely align with the group's risk management policies.

As assessment of the group's hedging relationships under IAS 39 has been performed and it has been determined that the relationships will qualify as continuing hedge relationships under IFRS 9. We do not anticipate the application of IFRS 9 hedge accounting requirements will have a material impact on the financial statements.

iv) Other
In addition, the following new accounting standards and amendments to existing standards have been issued but are not yet effective have not yet been endorsed by the EU:

- Amendments to IFRS 2 'Share Based Payments';
- IFRIC 22 'Foreign Currency Transactions and Advance Consideration;
- IFRIC 23 'Uncertainty over Income Tax';
- Amendments to IAS 40 'Investment Property';
- Amendments to IAS 28: Long-term interests in Associates and Joint Ventures;
- Annual improvements to IFRS standards 2015-2017 Cycle
- IFRS 17 'Insurance Contracts'; and
- Amendments to IAS 19 'Employee Benefits'.

Effective dates remain subject to the EU endorsement process.

The company is currently assessing the impact of the above standards, but they are not expected to have a material impact. The company has not early adopted any other standard, amendment or interpretation that was issued but is not yet effective.

Consolidated income statement

for the years ended 31 March

	Notes	2018 £m	2018 £m	2017 £m	2017 £m
Continuing operations					
Revenue	1 (a)		1,424		1,340
Operating costs	2		(777)		(876)
Operating profit					
Before exceptional items	1 (b)	647		573	
Exceptional items	3	-		(109)	
Total operating profit	1 (b)		647		464
Finance income	4		8		5
Finance costs					
Before exceptional items and remeasurements	4	(204)		(160)	
Exceptional items and remeasurements	3, 4	21		(7)	
Total finance costs	4		(183)		(167)
Profit before tax					
Before exceptional items and remeasurements		451		418	
Exceptional items and remeasurements	3	21		(116)	
Total profit before tax			472		302
Tax					
Before exceptional items and remeasurements	5	(98)		(66)	
Exceptional items and remeasurements	3, 5	(4)		63	
Total tax	5		(102)		(3)
Profit after tax					
Before exceptional items and remeasurements		353		352	
Exceptional items and remeasurements	3	17		(53)	
Profit after tax from continuing operations			370		299
Profit after tax from discontinued operations	7	17		314	
Gain on disposal of discontinued operations after tax	7	-		4,237	
			17		4,551
Total profit for the year (continuing and discontinued)			387		4,850
Attributable to:					
Equity shareholders of the parent			387		4,847
Non-controlling interests			-		3
			387		4,850

Consolidated statement of comprehensive income

for the years ended 31 March

	Notes	2018 £m	2017 £m
Profit for the year		387	4,850
Other comprehensive income from continuing operations:			
Items from continuing operations that will never be reclassified to profit or loss			
Remeasurement gains of pension assets	19	330	134
Tax on items that will never be reclassified to profit or loss	5	(55)	(23)
Total items from continuing operations that will never be reclassified to profit or loss		275	111
Other comprehensive income from continuing operations:			
Items from continuing operations that may be reclassified subsequently to profit or loss			
Net losses in respect of cash flow hedges[1]		(8)	(2)
Transferred to profit or loss on cash flow hedges		5	7
Tax on items that may be reclassified subsequently to profit or loss	5	-	(2)
Total items from continuing operations that may be reclassified subsequently to profit or loss		(3)	3
Other comprehensive income for the year, net of tax from continuing operations		272	114
Other comprehensive income for the year, net of tax from discontinued operations		-	51
Other comprehensive income for the year, net of tax		272	165
Total comprehensive income for the year from continuing operations		642	413
Total comprehensive income for the year from discontinued operations		17	4,602
Total comprehensive income for the year		659	5,015
Total comprehensive income for the year			
Attributable to:			
Equity shareholders of the parent			
From continuing operations		642	413
From discontinued operations		17	4,599
		659	5,012
Non-controlling interests			
From discontinued operations		-	3
		-	3
		659	5,015

1 The value of derivatives held to hedge cash flows is affected by changes in expected interest rates and in exchange rates. The net loss for the year was £8m (2017: net loss of £2m).

Consolidated statement of changes in equity

	Share capital £m	Share premium account £m	Retained earnings £m	Cash flow hedge reserve £m	Other reserves £m	Shareholders' equity £m	Non-controlling interests £m	Total equity £m
As at 1 April 2016	45	204	5,401	(61)	1,332	6,921	2	6,923
Profit for the year	-	-	4,847	-	-	4,847	3	4,850
Total other comprehensive income for the year	-	-	111	54	-	165	-	165
Total comprehensive income for the year	-	-	4,958	54	-	5,012	3	5,015
Equity dividends	-	-	(8,100)	-	-	(8,100)	-	(8,100)
Other movements in non-controlling interests	-	-	-	-	-	-	(5)	(5)
Share-based payments	-	-	7	-	-	7	-	7
Tax on share-based payments	-	-	(1)	-	-	(1)	-	(1)
As at 31 March 2017	45	204	2,265	(7)	1,332	3,839	-	3,839
Profit for the year	-	-	387	-	-	387	-	387
Total other comprehensive income for the year	-	-	275	(3)	-	272	-	272
Total comprehensive income for the year	-	-	662	(3)	-	659	-	659
Share-based payments	-	-	3	-	-	3	-	3
At 31 March 2018	**45**	**204**	**2,930**	**(10)**	**1,332**	**4,501**	**-**	**4,501**

The cash flow hedge reserve 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 £8m (2017: £5m), and the remainder to be released with the same maturity profile as borrowings due after more than one year.

Other reserves comprise the capital redemption reserve arising from the refinancing and restructuring of the Lattice Group in 1999. It represents the amount of the reduction in the share capital of the Company as a consequence of that restructuring. As the amounts included in other reserves are not attributable to any of the other classes of equity presented, they have been disclosed as a separate classification of equity.

Consolidated statement of financial position

as at 31 March

	Notes	2018 £m	2017 £m
Non-current assets			
Intangible assets	8	**113**	136
Property, plant and equipment	9	**4,416**	4,339
Other non-current assets	10	**3,514**	3,429
Derivative financial assets	11	**591**	813
Pensions asset	19	**412**	45
Total non-current assets		**9,046**	8,762
Current assets			
Inventories and current intangible assets	12	**23**	20
Trade and other receivables	13	**314**	520
Financial and other investments	14	**1,529**	1,856
Derivative financial assets	11	**43**	51
Cash and cash equivalents	15	**275**	-
Total current assets		**2,184**	2,447
Total assets		**11,230**	11,209
Current liabilities			
Borrowings	16	**(896)**	(846)
Derivative financial liabilities	11	**(65)**	(185)
Trade and other payables	17	**(632)**	(614)
Current tax liabilities		**(27)**	(9)
Provisions	20	**(70)**	(133)
Total current liabilities		**(1,690)**	(1,787)
Non-current liabilities			
Borrowings	16	**(4,139)**	(4,640)
Derivative financial liabilities	11	**(157)**	(234)
Other non-current liabilities	18	**(177)**	(189)
Deferred tax liabilities	5	**(437)**	(366)
Provisions	20	**(129)**	(154)
Total non-current liabilities		**(5,039)**	(5,583)
Total liabilities		**(6,729)**	(7,370)
Net assets		**4,501**	3,839
Equity			
Share capital	21	**45**	45
Share premium account		**204**	204
Retained earnings		**2,930**	2,265
Cash flow hedge reserve		**(10)**	(7)
Other reserves		**1,332**	1,332
Shareholders' equity		**4,501**	3,839
Non-controlling interests		**-**	-
Total equity		**4,501**	3,839

These consolidated financial statements set out on pages 47 to 90 were approved by the Board of Directors and authorised for issue on 21 June 2018. They were signed on its behalf by:

Nicola Shaw Chair

Alan Foster Director

National Grid Gas plc
Registered number: 2006000

Consolidated cash flow statement

for the years ended 31 March

	Notes	2018 £m	2017 £m
Cash flows from operating activities			
Total operating profit	1(b)	647	464
Adjustments for:			
Exceptional items	3	-	109
Depreciation, amortisation and impairment		246	258
Share-based payment charge		3	4
Changes in working capital		100	(43)
Changes in provisions		(29)	(65)
Loss on disposal of property, plant and equipment and intangible assets		25	18
Changes in pensions and other post-retirement benefit obligations		(36)	-
Cash flows relating to exceptional items		-	(22)
Cash generated from operations		956	723
Tax recovered/(paid)		16	(30)
Net cash inflow from operating activities - continuing operations		972	693
Net cash inflow from operating activities - discontinued operations		(98)	460
Cash flows from investing activities			
Purchases of intangible assets		(16)	(26)
Purchases of property, plant and equipment		(308)	(220)
Repayment of loan by group undertaking		-	2,183
Interest received		8	5
Movement in short-term financial investments		327	(1,719)
Net cash flow used in investing activities - continuing operations		11	223
Net cash flow from investing activities - discontinued operations[1]		-	6,585
Cash flows from financing activities			
Repayment of loans		(264)	(53)
Net settlement of short-term borrowings and derivatives		(10)	80
Interest paid		(100)	(93)
Dividends paid to shareholders		-	(8,100)
Net cash flow used in financing activities - continuing operations		(374)	(8,166)
Net cash flow from financing activities - discontinued operations		(231)	204
Net decrease in cash and cash equivalents	22(b)	280	(1)
Net cash and cash equivalents at the start of the year		(8)	(7)
Net cash and cash equivalents at the end of the year	15	272	(8)

1 Included within net cash flow from investing activities - discontinued operations is £nil (2017: £6,899m) of cash proceeds from the sale of the Gas Distribution business.

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

1. 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.

We work with our regulators to obtain robust regulatory agreements that balance the risks we face with the opportunity to deliver reasonable returns for our investors. Our regulated businesses earn revenue for the transmission and distribution (discontinued) services they have provided during the year. In any one year, the revenue recognised may differ from the revenue allowed under our regulatory agreements and any such timing differences are adjusted against future prices.

Revenue primarily represents the sales value derived from the transmission and distribution (discontinued) of gas and the provision of gas metering services during the year including an assessment of the value of services provided, but not invoiced, at the year end. It excludes value added tax and intra-group sales.

The sales value for the transmission and distribution (discontinued) of gas is largely determined from the amount of system capacity sold for the year, and the amount of gas transported for the year, evaluated at contractual prices on a monthly basis. The sales value for the provision of gas metering services is largely derived from monthly charges for the provision of individual meters under contractual arrangements.

Where revenue for the year exceeds the maximum amount permitted by regulatory agreement, and adjustments will be made to future prices to reflect this over-recovery, a liability for the over-recovery is not recognised because such an adjustment to future prices relates to the provision of future services. Similarly, an asset is not recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under-recovery.

Revenue includes income arising from the sale of properties as a result of property management activities, from the sale of emission allowances and from the recovery of pension deficit from other gas transporters under regulatory arrangement.

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 Gas plc'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 and remeasurements (see note 3).

There has been no change to the way in which our businesses have reported internally during the year. The following are the main activities for each operating segment:

1. **Gas Transmission** - The gas transmission network in Great Britain and liquefied natural gas (LNG) storage activities.
2. **Other activities** - Relate to the gas metering business, which provides regulated gas metering activities in the UK, together with corporate activities.

Sales between businesses are priced having regard to the regulatory and legal requirements that the businesses are subject to, which include requirements to avoid cross-subsidies.

(a) Revenue

	2018			2017		
	Total sales £m	**Sales between segments £m**	**Sales to third parties £m**	Total sales £m	Sales between segments £m	Sales to third parties £m
Operating segment						
Gas Transmission	**1,091**	**(4)**	**1,087**	1,095	(41)	1,054
Other activities	**342**	**(5)**	**337**	286	-	286
Continuing operations	**1,433**	**(9)**	**1,424**	1,381	(41)	1,340
Discontinued operations	**-**	**-**	**-**	943	(16)	927

Analysis of revenue by major customer:

	2018 £m	2017 £m
Customer A	**142**	153

No other single customer contributed 10% or more to the Group's revenue in either 2018 or 2017.

1. 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 and remeasurements are provided in note 3

	Before exceptional items and remeasurements		After exceptional items and remeasurements	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Operating segment				
Gas Transmission	**493**	419	**493**	330
Other activities	**154**	154	**154**	134
Continuing operations	**647**	573	**647**	464
Discontinued operations	**-**	396	**17**	396
Reconciliation to profit before tax from continuing operations:				
Operating profit	**647**	573	**647**	464
Finance income	**8**	5	**8**	5
Finance costs	**(204)**	(160)	**(183)**	(167)
Profit before tax from continuing operations	**451**	418	**472**	302
Profit before tax from discontinued operations	**-**	328	**17**	319

(c) Property, plant and equipment and intangible assets

	Net book value of property, plant and equipment and intangible assets		Capital expenditure		Depreciation, impairment and amortisation	
	2018 £m	2017 £m	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Operating segments						
Gas Transmission	**4,286**	4,165	**310**	214	**188**	182
Other activities	**243**	310	**30**	28	**58**	76
Continuing operations	**4,529**	4,475	**340**	242	**246**	258
Discontinued operations[1]	**-**	-	**-**	284	**-**	158
Continuing operations by asset type						
Property, plant and equipment	**4,416**	4,339	**324**	216	**216**	229
Intangible assets	**113**	136	**16**	26	**30**	29
	4,529	4,475	**340**	242	**246**	258
Discontinued operations by asset type[1]						
Property, plant and equipment	**-**	-	**-**	284	**-**	135
Intangible assets	**-**	-	**-**	-	**-**	23
	-	-	**-**	284	**-**	158

1 Comparative discontinued operations amounts relate to the Gas Distribution business disposed of last year.

2. Operating costs

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

	Before exceptional items and remeasurements		Exceptional items and remeasurements		Total	
	2018 £m	2017 £m	2018 £m	2017 £m	2018 £m	2017 £m
Depreciation, impairment and amortisation	246	258	-	-	246	258
Payroll costs	141	125	-	-	141	125
Purchases of gas	75	67	-	-	75	67
Rates	94	101	-	-	94	101
Pension deficit charges[1]	-	88	-	22	-	110
Inventory consumed	9	23	-	-	9	23
Operating leases	6	5	-	-	6	5
Research and development expenditure	4	4	-	-	4	4
Other	202	96	-	87	202	183
Continuing operations	777	767	-	109	777	876

1 Pension deficit charges arise from recovery plan contributions to the National Grid UK Pension Scheme prior to sectionalisation of this scheme. For further details see note 19.

(a) Payroll costs

	2018 £m	2017 £m
Wages and salaries	108	104
Social security costs	16	16
Pension costs (note 19)	33	21
Share-based payments	4	4
Severance costs (excluding pension costs)	2	2
	163	147
Less: payroll costs capitalised	(22)	(22)
Continuing operations	141	125

(b) Number of employees, including Directors

	31 March 2018 Number	31 March 2017 Number	Monthly average 2018 Number	Monthly average 2017 Number
Gas Transmission	1,044	932	986	916
Other[1]	1,090	993	1,006	1,090
Continuing operations	2,134	1,925	1,992	2,006
Discontinued operations[2]	-	-	-	4,021

1 Other comprises National Grid Metering and employees working in shared services supporting the Gas Transmission businesses.
2 Discontinued operations for 2017 represents the average number of employees employed for the six months prior to the Gas Distribution business being hived out on 1 October 2016.

(c) Key management compensation

	2018 £m	2017 £m
Short-term employee benefits	2	3
Share-based payment	1	1
Continuing operations	3	4

Key management comprises the Board of Directors of the Company together with those Executive Directors of National Grid plc who have managerial responsibility for any of the businesses of National Grid Gas plc.

2. Operating costs (continued)

(d) Directors' emoluments

The aggregate amount of emoluments (excluding social security, pensions and share-based payment) paid to the Directors of the company in respect of qualifying services for 2018 was £1,448,775 (2017: £2,184,719)

No Director including the highest paid Director exercised share options during 2018 (2017: four Directors including the highest paid Director).

A number of the current Directors are also Directors and employees of National Grid plc or a subsidiary undertaking of that Company and are paid by these companies.

As at 31 March 2018, retirement benefits were accruing to seven (2017: nine) Directors under a defined benefit scheme.

The aggregate emoluments for the highest paid Director were £512,696 for 2018 (2017: £626,609) and total accrued annual pension at 31 March 2018 for the highest paid Director was £nil (2017: £nil).

The aggregate amount of loss of office payments to Directors for 2018 was £nil (2017: £nil).

(e) Auditors' remuneration

	2018 £m	2017 £m
Audit services		
Audit of parent company and consolidated financial statements	0.4	0.5
Other services		
Fees payable to the company's auditors for audit-related assurance services	0.5	0.2
Other non-audit services	-	6.9

Fees payable to the Company's auditors for audit-related assurance services represent fees payable for services in relation to engagements which are required to be carried out by the auditors. Other non-audit services in the prior year primarily include amounts incurred in respect of the disposal of a majority stake in the Gas Distribution business (vendor due diligence and separation support). These fees have been subject to approval by the Audit Committee of National Grid plc.

3. Exceptional items and remeasurements

To monitor our financial performance, we use a profit measure that excludes certain income and expenses. We call that measure 'business performance' or 'adjusted profit'. We exclude items from business performance because we believe 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 and remeasurements; and exceptional items and remeasurements. 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.

Management utilises an exceptional items framework that has been discussed and approved by the National Grid Gas plc Audit Committee. This follows a three-step process which considers the nature of the event, the financial materiality involved and any particular facts and circumstances. In considering the nature of the event, management focuses on whether the event is within the Group's control and how frequently such an event typically occurs. In determining the facts and circumstances management considers factors such as ensuring consistent treatment between favourable and unfavourable transactions, precedent for similar items, number of periods over which costs will be spread or gains earned and the commercial context for the particular transaction.

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.

Remeasurements comprise gains or losses recorded in the income statement arising from changes in the fair value 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 financial indices and prices over which we have no control.

	2018 £m	2017 £m
Included within operating profit:		
Exceptional items:		
Profit on disposal of land and buildings[1]	-	109
Gas holder demolition costs[1]	-	(107)
Pension sectionalisation[2]	-	(89)
Pension deficit charges[3]	-	(22)
	-	(109)
Included within finance costs:		
Remeasurements:		
Net gains/(losses) on derivative financial instruments	21	(7)
	21	(7)
Total included within profit before tax	21	(116)
Included within taxation:		
Exceptional credit arising on items not included in profit before tax:		
Deferred tax credit arising on the reduction in the UK tax rate[4]	-	18
Tax on exceptional items	-	44
Tax on remeasurements	(4)	1
	(4)	63
Total exceptional items and remeasurements after tax	17	(53)
Analysis of total exceptional items and remeasurements after tax:		
Total exceptional items after tax	-	(47)
Total remeasurements after tax	17	(6)
Total exceptional items and remeasurements from continuing operations	17	(53)

3. Exceptional items and remeasurements (continued)

Further detail of exceptional items specific to 2017:

1 During October 2016, following the sale of the Gas Distribution business, the company sold 78 surplus land sites to a number of fellow National Grid Group undertakings, recognising a gain on disposal of £109m. A legal agreement was entered into with these National Grid Group companies to demolish the non-operational gas holders on these sites, creating a constructive obligation for the Company. As a result a provision of £107m was recognised at 31 March 2017.

2 With effect from 1 January 2017, sectionalisation of the National Grid UK Pension Scheme was carried out, resulting in separation of the scheme into three sections, each of which are legally and actuarially separate. Section B is included within National Grid Gas plc and the associated costs of £89m were recognised as exceptional in 2017, see note 19 for further details

3 Pension deficit charges arise from the recovery plan contributions to the National Grid UK Pension Scheme for certain employees in other activities which were incurred prior to sectionalisation of the scheme, see note 19.

4 The Finance No. 2 Bill 2015 resulted in a reduction in the UK corporation tax rate from 20% to 19% for the year beginning 1 April 2017, with a further reduction from 19% to 18% for the year beginning 1 April 2020. A further reduction to 17% with effect from 1 April 2020 was enacted in the Finance Act 2016. Deferred taxes at the reporting date have been measured using these enacted tax rates and reflected in these financial statements, resulting in a deferred tax credit. This credit was presented as exceptional, reflecting its nature.

Remeasurements

Net gains/losses arising from derivative instrument fair value movement 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.

4. Finance income and costs

This note details the interest income generated by our financial assets and the interest expense incurred on financial liabilities. In reporting business performance, we adjust net financing costs to exclude any net gains or losses on derivative financial instruments included in remeasurements.

	2018 £m	2017 £m
Finance income		
Interest income on financial instruments	7	5
Net interest on pension asset	1	-
	8	5
Finance costs		
Net interest on pension asset	-	(1)
Interest expense on financial liabilities held at amortised cost:		
Bank loans and overdrafts	(30)	(21)
Other borrowings	(235)	(204)
Derivatives	53	64
Unwinding of discount on provisions	(1)	(1)
Other interest	-	(2)
Less: interest capitalised[1]	9	5
	(204)	(160)
Remeasurements		
Net gains/(losses) on derivative financial instruments included in remeasurements[2]:		
Ineffectiveness on derivatives designated as:		
Fair value hedges[3]	26	21
Cash flow hedges	(2)	(3)
Derivatives not designated as hedges or ineligible for hedge accounting	(3)	(25)
Exceptional items and remeasurements included within finance costs	21	(7)
	(183)	(167)
Net finance costs from continuing operations	(175)	(162)

1 Interest on funding attributable to assets in the course of construction was capitalised during the year at a rate of 4.8% (2017: 3.4%). Capitalised interest qualifies for a current year tax deduction with tax relief claimed of £1m (2017: £1m).

2 Includes a net foreign exchange gain on financing activities of £99m (2017: £196m loss). These amounts are offset by foreign exchange gains and losses on derivative financial instruments measured at fair value.

3 Includes a net loss on instruments designated as fair value hedges of £66m (2017: £11m loss) offset by a net gain of £92m (2017: £32m gain) arising from the fair value adjustments to the carrying value of debt.

5. Taxation

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 are 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 Group 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.

Tax charged/(credited) to the income statement - continuing operations	2018 £m	2017 £m
Tax before exceptional items and remeasurements	98	66
Exceptional tax on items not included in profit before tax (note 3)	-	(18)
Tax on other exceptional items and remeasurements	4	(45)
Tax on total exceptional items and remeasurements (note 3)	4	(63)
Total tax charge from continuing operations	102	3

Taxation as a percentage of profit before tax	%	%
Before exceptional items and remeasurements - continuing operations	21.7	15.8
After exceptional items and remeasurements - continuing operations	21.6	1.0

The tax charge for the year can be analysed as follows:	2018 £m	2017 £m
Current tax		
UK corporation tax at 19% (2017: 20%)	88	106
UK corporation tax adjustment in respect of prior years	-	(25)
Total current tax from continuing operations	88	81
Deferred tax		
UK deferred tax	13	(65)
UK deferred tax adjustment in respect of prior years	1	(13)
Total deferred tax from continuing operations	14	(78)
Total tax charge from continuing operations	102	3

5. Taxation (continued)

Tax (credited)/charged to other comprehensive income and equity	2018 £m	2017 £m
Current tax		
Share-based payments	(2)	(2)
Deferred tax		
Share-based payments	2	1
Remeasurements of net retirement benefit obligations	55	23
Cash flow hedges	-	2
	55	24
Total tax recognised in the statement of comprehensive income from continuing operations	55	25
Total tax recognised in the statement of comprehensive income from discontinued operations	-	11
Total tax relating to share-based payments recognised directly in equity from continuing operations	-	(1)
	55	35

The tax charge for the year after exceptional items and remeasurements is higher (2017: lower) than the standard rate of corporation tax in the UK of 19% (2017: 20%):

	Before exceptional items and remeasure-ments 2018 £m	After exceptional items and remeasure-ments 2018 £m	Before exceptional items and remeasure-ments 2017 £m	After exceptional items and remeasure-ments 2017 £m
Profit before tax				
Before exceptional items and remeasurements	451	451	418	418
Exceptional items and remeasurements	-	21	-	(116)
Profit before tax from continuing operations	451	472	418	302
Profit before tax from continuing operations multiplied by UK corporation tax rate of 19% (2017: 20%)	86	90	84	60
Effects of:				
Adjustments in respect of prior years	1	1	(38)	(38)
Expenses not deductible for tax purposes	14	14	26	26
Non-taxable income	(1)	(1)	(6)	(27)
Deferred tax impact of change in UK tax rate	(2)	(2)	-	(18)
Total tax from continuing operations	98	102	66	3
	%	%	%	%
Effective tax rate - continuing operations	21.7	21.6	15.8	1.0

Factors that may affect future tax charges

The Finance Act 2016 which was enacted on 15 September 2016 reduced the main rate of UK corporation tax to 17% with effect from 1 April 2020. Deferred tax balances have been calculated at this rate.

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:

5. Taxation (continued)

Deferred tax (assets)/liabilities	Pensions £m	Accelerated tax depreciation £m	Share-based payment £m	Financial instruments £m	Other net temporary differences £m	Total £m
Deferred tax assets at 31 March 2016	-	-	(5)	(7)	(6)	(18)
Deferred tax liabilities at 31 March 2016	-	1,557	-	-	9	1,566
At 1 April 2016	-	1,557	(5)	(7)	3	1,548
Credited to income statement	(15)	(124)	-	(4)	(12)	(155)
Charged to other comprehensive income and equity	23	-	1	12	-	36
Discontinued Operations	-	(1,065)	-	-	2	(1,063)
At 31 March 2017	8	368	(4)	1	(7)	366
Deferred tax assets at 31 March 2017	-	-	(4)	-	(10)	(14)
Deferred tax liabilities at 31 March 2017	8	368	-	1	3	380
At 1 April 2017	8	368	(4)	1	(7)	366
Charged to income statement	6	3	1	(1)	5	14
Charged/(credited) to other comprehensive income and equity	55	-	2	-	-	57
At 31 March 2018	**69**	**371**	**(1)**	**-**	**(2)**	**437**
Deferred tax assets at 31 March 2018	-	-	(1)	-	(6)	(7)
Deferred tax liabilities at 31 March 2018	69	371	-	-	4	444
At 31 March 2018	**69**	**371**	**(1)**	**-**	**(2)**	**437**

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 £437m (2017: £366m). At the balance sheet date there were no material current deferred tax assets or liabilities (2017: £nil).

6. 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 meet our gearing target, 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 dividends paid to equity shareholders:

	2018		2017	
	pence (per ordinary share)	**£m**	pence (per ordinary share)	£m
Ordinary dividends				
Interim dividend paid in the year	-	-	205.38	8,100

No dividends were paid by National Grid Gas plc during the year. (2017: Interim dividend A: £5,917m and interim dividend B: £2,183m together, the interim dividends). The prior year interim dividends were made to ensure partial distribution of the proceeds from the Gas Distribution business.

7. Discontinued Operations

Our results and cash flows of significant assets or businesses sold during the year are shown separately from our continuing operations. As a result of the sale of Gas Distribution on 1 October 2016, we are required to report our earnings for the Group excluding Gas Distribution ('continuing operations') separately from the results of that business, which we report within 'discontinued operations'. All costs associated with the transaction, including those associated with separation and setting up Gas Distribution are shown as a deduction from the proceeds received. Any adjustments arising as part of the completion adjustments finalised within the measurement period would result in a further gain or loss on disposal to be reported within discontinued operations in the current period.

Disposal of Gas Distribution

On 1 October 2016, National Grid Gas plc completed the sale of the trade and assets of the Gas Distribution business to a separate statutory entity, National Grid Gas Distribution Limited. Further details are included in the Annual Report and Accounts 2016/17.

The Gas Distribution business represented a reportable segment and a separate major line of business and accordingly was presented as a discontinued operation in the consolidated income statement, consolidated statement of comprehensive income and the consolidated cash flow statement in 2016/17.

In 2017/18, a profit of £17m is reported in discontinued operations, which relates to the reversal of provisions in respect of business restructuring costs following the sale of the Gas Distribution business.

In addition, there was a cash outflow from operating activities of £98m related to the utilisation of provisions and accruals, principally relating to payments of professional fees in respect of the sale of the Gas Distribution business.

Summary income statement – discontinued operations

The summary income statement for discontinued operations for the years ended 31 March 2017 and 2016 are as follows.

	2017 £m	2016 £m
Revenue	927	1,913
Operating costs	(531)	(1,056)
Operating profit	396	857
Finance income	1	-
Finance costs	(78)	(115)
Profit before tax from discontinued operations	319	742
Tax from discontinued operations	(5)	(25)
Profit after tax from discontinued operations	314	717
Gain on disposal of discontinued operations	4,024	-
Taxation on gain on disposal of discontinued operations	213	-
Gain on disposal of discontinued operations after tax	4,237	-
Total profit after tax from discontinued operations	4,551	717

8. Intangible assets

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

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

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

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

Intangible assets under development are not amortised. Other non-current intangible assets are amortised on a straight-line basis over their estimated useful economic lives. The amortisation period for software is up to eight years.

	Software £m
Cost at 1 April 2016	630
Additions	26
Reclassifications[1]	3
Disposals	(10)
Disposal of discontinued operations	(300)
Cost at 31 March 2017	349
Additions	16
Reclassifications[1]	2
Disposals	(21)
Transfers[2]	(10)
Cost at 31 March 2018	336
Accumulated amortisation at 1 April 2016	(378)
Amortisation charge for the year	(52)
Disposals	9
Disposal of discontinued operations	208
Accumulated amortisation at 31 March 2017	(213)
Amortisation charge for the year	(30)
Disposals	20
Accumulated amortisation at 31 March 2018	(223)
Net book value at 31 March 2018	**113**
Net book value at 31 March 2017	136

1 Reclassifications represents amounts transferred from property, plant and equipment, see note 9

2 Transfers represents assets transferred to a fellow group undertaking in the year.

9. Property, plant and equipment

This 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.

We operate a gas transmission business and therefore have a significant physical asset base. We continue to invest in our network 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.

All contributions received prior to 1 July 2009 towards the cost of property, plant and equipment and contributions received post 1 July 2009 towards the altering, diverting or relocating a tangible fixed asset 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 towards the cost of tangible fixed assets from customers for connections to the gas transmission and distribution networks are initially recognised as deferred income and credited to revenue once the connection has been completed. Contributions received post 1 July 2009 towards the provision of ongoing access to a supply of services 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 assessment 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:

Depreciation periods	Years
Freehold and leasehold buildings	5 to 50
Plant and Machinery	
- mains, services and regulating equipment	5 to 60
- other	5 to 50
Motor vehicles and office equipment	3 to 10

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

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

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

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

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

9. 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 2016	447	19,513	266	577	20,803
Additions	10	319	144	27	500
Disposals	(21)	(248)	(5)	(111)	(385)
Disposal of discontinued operations	(62)	(11,612)	(75)	(286)	(12,035)
Reclassifications [1]	(11)	49	(61)	20	(3)
Cost at 31 March 2017	363	8,021	269	227	8,880
Additions	6	124	188	6	324
Disposals[2]	(4)	(47)	(8)	(11)	(70)
Reclassifications[1]	(68)	109	(47)	4	(2)
Transfers[3]	(4)	-	-	(1)	(5)
Cost at 31 March 2018	293	8,207	402	225	9,127
Accumulated depreciation at 1 April 2016	(221)	(7,443)	-	(485)	(8,149)
Depreciation charge for the year	(37)	(302)	-	(25)	(364)
Disposals	17	240	-	111	368
Accumulated depreciation on disposal of discontinued operations	27	3,375	-	202	3,604
Accumulated depreciation at 31 March 2017	(214)	(4,130)	-	(197)	(4,541)
Depreciation charge for the year	(20)	(185)	-	(8)	(213)
Disposals[2]	3	32	-	11	46
Reclassifications [1]	48	(48)	-	-	-
Impairment	-	(3)	-	-	(3)
Accumulated depreciation at 31 March 2018	(183)	(4,334)	-	(194)	(4,711)
Net book value at 31 March 2018	**110**	**3,873**	**402**	**31**	**4,416**
Net book value at 31 March 2017	149	3,891	269	30	4,339

1 Represents amounts transferred between categories and also to intangible assets (see note 8).
2 Disposals includes £20m of nil net book value assets written off.
3 Transfers represents assets transferred to a fellow group undertaking in the year.

	2018 £m	2017 £m
Information in relation to property, plant and equipment		
Capitalised interest included within cost	239	229
Contributions to cost of property, plant and equipment included within:		
Trade and other payables	3	3
Non-current liabilities	138	140

10. Other non-current assets

Other non-current assets includes assets that do not fall into any other non-current asset category (such as property, plant and equipment) and the benefit to be received from the asset is not due to be received until after 31 March 2019.

	2018 £m	2017 £m
Loans and receivables - amounts owed by parent undertaking [1]	3,427	3,426
Prepayments	87	3
	3,514	3,429

1 The amount owed by parent undertaking is non-contractual, and its fair value is approximate to book value.

11. Derivative financial instruments

Derivatives are financial instruments that derive their value from the price of an underlying item such as interest rates, foreign exchange rates, credit spreads, equity or other indices. In accordance with the Board approved policies, derivatives are transacted generally 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.

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, in either the income statement or other comprehensive income as required by IAS 39. 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 the fair value of 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 25.

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

	2018			2017		
	Asset £m	Liabilities £m	Total £m	Asset £m	Liabilities £m	Total £m
Interest rate swaps	291	(94)	197	363	(151)	212
Cross-currency interest rate swaps	338	(7)	331	486	(7)	479
Foreign exchange forward contracts[1]	-	-	-	8	(4)	4
Inflation linked swaps	5	(121)	(116)	7	(257)	(250)
	634	(222)	412	864	(419)	445

[1] Included within the foreign excange forward contracts balance is £nil (2017: £4m) of derivatives in relation to capital expenditure.

The maturity profile of derivative financial instruments is as follows:

	2018			2017		
	Assets £m	Liabilities £m	Total £m	Assets £m	Liabilities £m	Total £m
Current						
Less than 1 year	43	(65)	(22)	51	(185)	(134)
	43	(65)	(22)	51	(185)	(134)
Non-current						
In 1 - 2 years	42	(15)	27	69	(52)	17
In 2 - 3 years	-	-	-	76	(30)	46
In 3 - 4 years	337	(5)	332	-	-	-
In 4 - 5 years	9	-	9	412	(7)	405
More than 5 years	203	(137)	66	256	(145)	111
	591	(157)	434	813	(234)	579
	634	(222)	412	864	(419)	445

For each class of derivative the notional contract amounts[1] are as follows:

	2018 £m	2017 £m
Interest rate swaps	(2,473)	(3,173)
Cross-currency interest rate swaps	(751)	(728)
Foreign exchange forward contracts	(3)	(56)
Inflation linked swaps	(696)	(784)
	(3,923)	(4,741)

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

11. Derivative financial instruments (continued)

Where possible, derivatives held as hedging instruments are formally designated as hedges as defined in IAS 39 'Financial Instruments: Recognition and Measurement'. 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. National Grid Gas uses two hedge accounting methods, which are described as below.

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 instruments. To qualify for hedge accounting, documentation is prepared specifying the hedging strategy, the component transactions and methodology used for effectiveness measurement.

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 offset 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.

	2018 £m	2017 £m
Cross-currency interest rate/interest rate swaps	**416**	537

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.

When a forecast transaction is no longer expected to occur, the cumulative gain or loss previously 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.

	2018 £m	2017 £m
Cross-currency interest rate/interest rate swaps	**41**	72
Foreign exchange forward contracts	**-**	4
Cash flow hedges	**41**	76

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.

	2018 £m	2017 £m
Cross-currency interest rate/interest rate swaps	**71**	83
Inflation linked swaps	**(116)**	(251)
Derivatives not in a formal hedge relationship	**(45)**	(168)

11. Derivative financial instruments (continued)

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 profit or loss, unless the hedged item is no longer expected to occur ain which case the amounts would be recognised immediately. 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.

12. Inventories and current intangible assets

Inventories represent assets that we intend to use in order to generate revenue in future periods, through use either 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, 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.

	2018 £m	2017 £m
Raw materials and consumables	18	18
Current intangible assets - emission allowances	5	2
	23	20

There is a provision for obsolescence of £3m against inventories as at 31 March 2018 (2017: £5m).

13. Trade and other receivables

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

Trade receivables are non-interest bearing and generally have a 30 to 90 day term. Due to their short maturities, the fair value of trade and other receivables approximates their book value.

	2018 £m	2017 £m
Trade receivables	95	85
Amounts owed by fellow subsidiaries of National Grid plc	34	155
Accrued income	144	147
Prepayments	27	119
Other receivables	14	14
	314	520

Provision for impairment of receivables	2018 £m	2017 £m
At 1 April	-	1
Amounts recovered in the year	-	(1)
At 31 March	-	-

Trade receivables past due but not impaired

	2018 £m	2017 £m
Up to 3 months past due	1	5
3 to 6 months past due	-	-
Over 6 months past due	-	-
	1	5

For further information about wholesale credit risk refer to note 25(a).

14. Financial and other investments

Financial and other investments include 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. Loans and receivables include 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.

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 other comprehensive income, 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.

	2018 £m	2017 £m
Current		
Available-for-sale investments - investments in short-term money funds [1]	769	1,632
Loans and receivables - amounts due from fellow subsidiaries	667	21
Loans and receivables - restricted cash balances [2]	93	203
	1,529	1,856

1 The available-for-sale investments at 31 March 2018 solely relate to investments in short-term money funds.

2 Comprises collateral placed with counterparties with whom we have entered into a credit support annex to the ISDA Master Agreement.

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 25(a). None of the financial investments are past due or impaired.

15. Cash and cash equivalents

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

Net cash and cash equivalents reflected in the cash flow statement are net of bank overdrafts, which are reported in borrowings.

The carrying amounts of cash and cash equivalents and bank overdrafts approximate their fair values.

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

Net cash and cash equivalents held in currencies other than sterling have been converted into sterling at year-end exchange rates. For further information on currency exposures, refer to note 25(d).

	2018 £m	2017 £m
Cash at bank and short-term deposits [1]	275	-
Cash and cash equivalents excluding bank overdrafts	275	-
Bank overdrafts (note 16)	(3)	(8)
Net cash and cash equivalents	272	(8)

1 Represents term deposits with a one week maturity date.

16. Borrowings

We borrow money primarily in the form of bonds, borrowings from fellow subsidiaries and bank loans. These are for a fixed term and may have fixed or floating interest rates or are linked to the retail price index (RPI). As indicated in note 11, we use derivatives to manage risks associated with interest rates and foreign exchange.

Our price controls require us to fund our networks with 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 value 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 ratings 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.

	2018 £m	2017 £m
Current		
Bank loans	414	529
Bonds	478	308
Other loans	1	1
Bank overdrafts (see note 15)	3	8
	896	846
Non-current		
Bank loans	508	490
Bonds	3,462	3,961
Other loans	169	189
	4,139	4,640
Total	5,035	5,486

Total borrowings are repayable as follows:	2018 £m	2017 £m
Less than 1 year	896	846
In 1 - 2 years	212	470
In 2 - 3 years	8	226
In 3 - 4 years	818	8
In 4 - 5 years	740	893
More than 5 years:		
by instalments	51	51
other than by instalments	2,310	2,992
	5,035	5,486

The fair value of borrowings at 31 March 2018 was £6,374m (2017: £6,777m). Where market values were available, fair value of borrowings (Level 1) was £1,512m (2017: £2,149m). Where market values were not available, the fair value of borrowings (Level 2) was £4,862m (2017: £4,628m), calculated by discounting cash flows at prevailing interest rates. The notional amount outstanding of the debt portfolio at 31 March 2018 was £5,048m (2017: £5,454m).

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

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 £412m (2017: £527m) in respect of cash received under collateral agreements.

At 31 March 2018, we had bilateral committed credit facilities of £350m (2017: £350m) of which £350m was undrawn (2017: £350m undrawn). All of the unused facilities at 31 March 2018 and 31 March 2017 are available for liquidity purposes.

Of the £350m of undrawn committed borrowings facilities due to expire within 1 to 2 years, £350m was renegotiated before 31 March 2018, with effect from 1 June 2018. The amount was unchanged with the expiry extended to more than 5 years.

17. 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 delivered the associated service. These amounts are recognised as revenue when the service is provided.

Trade payables are initially recognised at fair value and subsequently measured at amortised cost. Due to their short maturities, the fair value of trade and other payables approximates their book value.

	2018 £m	2017 £m
Trade payables	228	240
Amounts owed to fellow subsidiaries of National Grid plc	265	237
Deferred income	30	20
Social security and other taxes	55	68
Other payables	54	49
	632	614

18. Other non-current liabilities

Other non-current liabilities include deferred income which will not be recognised as income until after 31 March 2018. It also includes payables that are not due until after that date.

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.

	2018 £m	2017 £m
Trade payables	6	-
Deferred income	33	177
Other payables	138	12
	177	189

19. Pensions and other post-employment benefit obligations

We have employees who are members of the National Grid UK Pension Scheme (Section B) which is a defined benefit scheme closed to new entrants. Membership of the National Grid YouPlan (YouPlan) defined contribution trust is offered to all new employees. YouPlan was launched in 2013 and under the rules of the plan, National Grid double matches contributions to YouPlan up to a maximum of 6% of employee salary. YouPlan is the qualifying scheme used for automatic enrolment and new hires are enroled into YouPlan.

The fair value of defined benefit scheme assets and present value of defined benefit obligations are updated annually in accordance with IAS 19 (revised).

During the year ended 31 March 2017, in order for the Gas Distribution business to be sold externally, the National Grid UK Pension Scheme was split into three sections. Pension benefits for National Grid Gas plc are included with section B. This has resulted in a change in National Grid Gas from recognising a pension charge for the year and recognising the scheme as if it were a defined contribution scheme to recognising a net pension asset on the statement of financial position and accounting as a defined benefit scheme.

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

For the defined contribution plan (DC), the Group pays contributions into a separate fund 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 the defined benefit retirement scheme, 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 scheme.

The cost of providing benefits in a defined benefit scheme 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 the defined benefit pension scheme is calculated separately 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.

The Group takes advice from an independent actuary 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 defined benefit pension obligations 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. Scheme 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.

The scheme'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. 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.

19. Pensions and post-employment benefit obligations (continued)

Section B of the National Grid UK Pension Scheme

The actuarial valuation as at 31 March 2017 determined that Section B was in deficit. National Grid and the Trustee agreed on a schedule of contributions, whereby deficit funding contributions of approximately £32 million payable by 30 September each year from 2017 onwards until 30 September 2022, with an additional £8 million payable by 30 September 2023. All deficit funding amounts due will be adjusted for the change in the Retail Price Index (RPI) from 31 December 2016 up to 3 months prior to the date of payment. As a result, the funding shortfall is expected to be eliminated by 30 September 2023. The employers will also contribute 51.4% of pensionable salary, less member contributions, in respect of ongoing service cost. The next actuarial valuation will be performed as at 31 March 2019.

The 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 has since been replaced by The National Grid YouPlan (YouPlan)

Actuarial information

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 defined benefit scheme.

The National Grid UK Pension Scheme is funded with assets held in a separate trustee administered fund. The arrangements are managed by a trustee company with a board 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 National Grid, the qualified actuary certifies the rate of employers' contribution, which, together with the specified contributions payable by the employees and proceeds from the scheme's assets, are expected to be sufficient to fund the benefits payable.

The results of 2017 actuarial valuation for section B of the NG UKPS are shown below:

Latest full actuarial valuation	31 March 2017
Actuary	Willis Towers Watson
Market value of scheme assets at latest valuation	£5,849m
Actuarial value of benefits due to members	£6,057m
Market value as percentage of benefits	97%
Funding deficit	£208m
Funding deficit (net of tax)	£173m

Accounting entries for pensions are updated annually. The following information relates to the amounts included in the annual report in accordance with our accounting policies.

	2018 £m	2017 £m
Amounts recognised in the statement of financial position		
Present value of funded obligations	(5,321)	(5,806)
Fair value of scheme assets	5,733	5,851
	412	45
Present value of unfunded obligations	-	-
Net defined benefit asset	412	45
Represented by:		
Assets	412	45
	412	45

19. Pensions and post-employment benefit obligations (continued)

Amounts recognised in the income statement and the statement of other comprehensive income	2018 £m	2017 £m
Included within operating costs		
Administration costs	3	1
Included within payroll costs		
Defined contribution scheme costs	10	14
Defined benefit scheme costs:		
Current service cost	18	5
Special termination benefit cost - redundancies	5	1
	33	20
Total of operating costs (defined benefit and defined contribution)	36	21
Included within finance income and costs		
Interest (credit)/cost	(1)	1
Total included in the income statement	35	22
Actuarial gain on defined benefit obligation in the period	336	51
Return on assets (less)/greater than discount rate	(6)	83
Total included in the statement of other comprehensive income	330	134

Reconciliation of the net defined benefit asset

	2018 £m	2017 £m
Opening defined benefit asset/(liability) at 1 April	45	(89)
Net cost recognised in the income statement	(25)	(8)
Remeasurement effects recognised in the statement of other comprehensive income	330	134
Employer contributions	62	8
Closing net defined benefit asset at 31 March	412	45

19. Pensions and post-employment benefit obligations (continued)

	2018 £m	2017 £m
Changes in the present value of defined benefit obligations (including unfunded obligations)		
Opening defined benefit obligations at 1 April	(5,806)	(5,878)
Defined benefit operating costs	(26)	(5)
Interest on defined benefit obligation	(136)	(37)
Remeasurement of the defined benefit obligations	336	51
Special termination benefit cost - redundancies	-	(1)
Administration costs	3	-
Benefits paid	218	64
Net transfers	90	
Closing defined benefit obligations at 31 March	(5,321)	(5,806)
Changes in the fair value of scheme assets		
Opening fair value of scheme assets at 1 April	5,851	5,789
Interest on assets	137	36
Return on assets (less)/greater than assumed	(6)	83
Administration costs	(3)	(1)
Employer contributions	62	8
Benefits paid	(218)	(64)
Net transfers	(90)	-
Closing fair value of scheme assets at 31 March	5,733	5,851
Actual return on scheme assets	131	119
Expected contributions to defined benefit scheme in the following year	56	50

Asset allocations

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

	2018 Quoted £m	2018 Unquoted £m	2018 Total £m	2017 Quoted £m	2017 Unquoted £m	2017 Total £m
Equities	602	228	830	798	237	1,035
Corporate bonds	1,709	-	1,709	1,657	-	1,657
Government securities	2,418	-	2,418	2,389	-	2,389
Property	-	339	339	-	294	294
Diversified alternatives [1]	-	329	329	-	299	299
Other	-	108	108	-	177	177
	4,729	1,004	5,733	4,844	1,007	5,851

[1] Includes return seeking non-conventional asset classes

19. Pensions and post-employment benefit obligations (continued)

Target asset allocations

National Grid UK (Section B) Pension Scheme'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 scheme as at 31 March 2018 is as follows:

	2018 %	2017 %
Equities	14	18
Other	86	82
	100	100

Actuarial assumptions

The following financial assumptions have been applied in assessing defined benefit liabilities.

	2018 %	2017 %
Discount rate[1] – past service[2]	2.60	2.40
Discount rate[1] – future service[2]	2.65	2.65
Rate of increase in salaries[3]	3.40	3.50
Rate of increase in RPI – past service[4]	3.15	3.20
Rate of increase in RPI – future service[4]	3.10	3.15

1 The discount rates for pension liabilities have been determined by reference to appropriate yields on high-quality corporate bonds prevailing in the UK debt markets at the reporting date.

2 In the UK, the 2017 discount rate was 2.4% p.a. for both accrued (past service) benefits and for accruing (future service) benefits based on an expected duration of scheme liabilities of 17 years. For 2018, National Grid has adopted a different discount rate assumption by increasing the duration of scheme liabilities to 25 years for future service obligations. This has led to a future service discount rate in the UK of 2.65% p.a. for both the 2017 and 2018 year-ends.

3 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 past service after this date is 2.20% (2017: 2.20%)and for future service 2.15% (2017: 2.20%). The rates of increase stated are not indicative of historical increases awarded or a guarantee of future increases, but merely an appropriate assumption utilised in assessing DB liabilities.

4 This is the key assumption that determines assumed increases in pensions in payment and deferment in the UK only. Consistent with the derivation of the discount rate, the RPI assumption reflects the duration of the active liabilities to be adopted in the calculation of the future service obligations. This approach leads to a RPI assumption for the future service rate of 3.10% p.a. at reporting date (2017: 3.15%), as compared to the 2017 published assumption of 3.20% for both past service and future service.

For sensitivity analysis, see note 26.

Assumed life expectations for a retiree age 65.	2018 years	2017 years
Today:		
Males	22.3	22.8
Females	23.9	24.6
In 20 years:		
Males	23.7	25.0
Females	25.5	26.8

20. 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 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.

We are committed to the protection and enhancement of the environment. However, we have acquired, owned and operated a number of assets 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.

	Decommissioning £m	Environmental £m	Restructuring	Other £m	Total provisions £m
At 1 April 2016	47	64	18	53	182
Additions	107	3	1	138	249
Unused amounts reversed	-	(19)	(1)	(3)	(23)
Unwinding of discount	-	1	-	-	1
Utilised	(10)	-	(15)	(3)	(28)
Disposal as a result of discontinued operations	(26)	(27)	-	(41)	(94)
At 31 March 2017	118	22	3	144	287
Additions	-	-	5	6	11
Reclassifications [1]	-	-	-	34	34
Unused amounts reversed	(11)	-	(3)	(33)	(47)
Unwinding of discount	1	1	-	-	2
Utilised	(4)	-	-	(84)	(88)
At 31 March 2018	**104**	**23**	**5**	**67**	**199**

[1] Reclassification of £34m relates to an in year reclassification of the prior year Crop and Quarry accrual to provision.

	2018 £m	2017 £m
Current	**70**	133
Non-current	**129**	154
	199	287

Decommissioning provision

The decommissioning provision represents expenditure relating to the demolition of gas and LNG storage facilities expected to be incurred until 2026. Unused amounts reversed of £11m represents the release of a provision for the demolition of LNG storage facilities.

During October 2016, following the sale of the Gas Distribution business, the company sold 78 surplus land sites to a number of fellow National Grid Group undertakings, recognising a gain on disposal of £109m. A legal agreement was entered into with these National Grid Gas Group companies to demolish the non-operational gas holders on these sites, creating a constructive obligation for the Company.

20. Provisions (continued)

Environmental provision

The environmental provision represents the estimated restoration and remediation costs relating to old gas manufacturing sites owned by the Company (discounted using a real rate of 1.0%). Cash flows are expected to be incurred between 2018 and 2075.

A number of uncertainties affect the calculation of the provision including the impact of regulation, the accuracy of the site surveys, unexpected contaminants, transportation costs, the impact of alternative technologies and changes in the discount rate. The provision incorporates our best estimate of the financial effect of these uncertainties, but future material changes in any of the assumptions could materially impact the calculation of the provision. The undiscounted amount of the provision at 31 March 2018 was £28m (2017: £27m), being the undiscounted best estimate of the liability having regard to these uncertainties.

Restructuring provision

The restructuring provision principally relates to business reorganisation costs in the UK and is expected to be incurred until 2019.

Other provisions

Other provisions at 31 March 2018 include £40m (2017: £134m) in respect of business set up costs and business restructuring costs. We expect the majority of this provision to be utilised within one year. Unused amounts reversed of £33m principally represents amounts released from the crop and quarry provision of £14m and amounts released in respect of business set up and restructuring costs of £17m. Amounts utilised of £84m principally relates to the utilisation of provisions in respect of business set up and restructuring costs.

21. Share capital

Ordinary share capital represents the total number of shares issued.

Share capital is accounted for as an equity instrument. An equity instrument is any contract that includes a residual interest in the consolidated assets of the Company after deducting all its liabilities and is recorded 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.

	Number of shares 2018 millions	Number of shares 2017 millions	2018 £m	2017 £m
At 31 March - ordinary shares of $1^{2}/_{15}$p each at Allotted, called-up and fully paid	3,944	3,944	45	45

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

22. Net Debt

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

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

	2018 £m	2017 £m
Increase in cash and cash equivalents	280	2
(Decrease)/increase in financial investments	(327)	1,719
Decrease/(increase) in borrowings and related derivatives	505	(947)
Net interest paid on the components of net debt	89	803
Change in net debt resulting from cash flows	547	1,577
Changes in fair value of financial assets and liabilities and exchange movements	19	(131)
Net interest charge on the components of net debt	(200)	(1,141)
Disposal of Gas Distribution business	-	4,051
Other non-cash movements	-	911
Movement in net debt (net of related derivative financial instruments) in the year	366	5,267
Net debt (net of related derivative financial instruments) at the start of the year	(3,185)	(8,452)
Net debt (net of related derivative financial instruments) at the end of the year	(2,819)	(3,185)

Composition of net debt

Net debt is made up as follows:

	2018 £m	2017 £m
Cash, cash equivalents and financial investments	1,804	1,856
Borrowings and bank overdrafts	(5,035)	(5,486)
Derivatives	412	445
Total net debt	(2,819)	(3,185)

(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 debt £m
At 1 April 2016	-	(7)	(7)	137	(9,096)	514	(8,452)
Cash flow	-	2	2	1,713	112	(250)	1,577
Fair value gains and losses and exchange movements	-	-	-	-	(173)	42	(131)
Interest charges	-	-	-	6	(1,118)	(29)	(1,141)
Other non-cash movements	-	-	-	-	747	164	911
Disposal	-	(3)	(3)	-	4,050	4	4,051
At 31 March 2017	-	(8)	(8)	1,856	(5,478)	445	(3,185)
Cash flow	275	5	280	(335)	512	90	547
Fair value gains and losses and exchange movements	-	-	-	-	196	(180)	16
Interest charges	-	-	-	8	(265)	57	(200)
Other non-cash movements	-	-	-	-	3	-	3
At 31 March 2018	275	(3)	272	1,529	(5,032)	412	(2,819)
Balances at 31 March 2018 comprise:							
Non-current assets	-	-	-	-	-	591	591
Current assets	275	(3)	272	1,529	-	43	1,844
Current liabilities	-	-	-	-	(893)	(65)	(958)
Non-current liabilities	-	-	-	-	(4,139)	(157)	(4,296)
	275	(3)	272	1,529	(5,032)	412	(2,819)

23. Commitments and contingencies

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

Future capital expenditure

	2018 £m	2017 £m
Contracted for but not provided	299	372

Operating lease commitments

	2018 £m	2017 £m
Amounts due:		
Less than 1 year	6	7
In 1 - 2 years	5	6
In 2 - 3 years	3	5
In 3 - 4 years	3	4
In 4 - 5 years	3	4
More than 5 years	5	9
	25	35

Other commitments, contingencies and guarantees

The value of other commitments and guarantees at 31 March 2018 amounted to £89m (2017: £31m), including energy purchase commitments amounting to £8m (2017: £25m). 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 (i.e. normal purchase, sale or usage) and hence are accounted for as ordinary purchase contracts.

Parent Company loan guarantees on behalf of subsidiaries

The Company has guaranteed the repayment of principal sums, any associated premium and interest on specific loans due from its subsidiaries to third parties. At 31 March 2018, the sterling equivalent amounted to £1,084m (2017: £992m).

Amounts receivable under sublease arrangements

The total of future minimum sublease payments expected to be received under non-cancellable subleases is £nil (2017: £1m).

Litigation and claims

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.

24. Related party transactions

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

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

	2018 £m	2017 £m
Income		
Goods and services supplied	224	189
Expenditure		
Services received	28	28
Corporate services received	8	14
Charges in respect of pensions costs	13	37
Interest paid on borrowings from ultimate parent company	-	7
	49	86
Outstanding balances at 31 March in respect of income, expenditure and settlement of corporation tax:		
Amounts receivable	51	169
Amounts payable	370	257
Advances to parent (due within one year):		
At 31 March	21	21
Advances to ultimate parent company (due after more than one year):		
At 31 March	3,426	3,426
Borrowings payable to ultimate parent company (amounts due within one year):		
At 31 March	645	-

There were no advances to other related parties at 31 March 2018 (2017:£nil)

Amounts receivable from or payable to related parties in respect of sales and expenditure are ordinarily settled one month in arrears. The advance to the parent due after more than one year is not interest bearing. Advances to and borrowings from fellow subsidiaries are repayable on demand and bear interest at commercial rates.

No amounts have been provided at 31 March 2018 (2017: £nil) and no expense has been recognised during the year (2017: £nil) in respect of bad or doubtful debts for related party transactions.

Details of guarantees provided in respect of related parties are provided in note 23

Details of key management compensation are provided in note 2(c).

25. Financial risk management

Our activities expose us to a variety of financial risks including currency risk, interest rate 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 from 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 National Grid plc 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; 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 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. Our limits are managed by the central treasury department of National Grid plc.

As at 31 March 2017 and 2018, 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.

Customer credit risk

Our principal commercial exposure is governed by the credit rules within the Uniform Network Code. These set out the level of credit relative to the regulatory asset value (RAV) for each credit rating. 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. 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 13.

Offsetting financial assets and liabilities

The following tables set out 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 Gas'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.

National Grid Gas 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.

25. Financial risk management (continued)

As at 31 March 2018	Gross carrying amounts £m	Gross amounts offset £m	Net amount presented in statement of financial position £m	Related amounts available to be offset but not offset in statement of financial position: Financial instruments £m	Related amounts available to be offset but not offset in statement of financial position: Cash collateral received/ pledged £m	Net amount £m
Assets						
Derivative financial instruments	634	-	634	(95)	(407)	132
	634	-	634	(95)	(407)	132
Liabilities						
Derivative financial instruments	(222)	-	(222)	95	87	(40)
	(222)	-	(222)	95	87	(40)
Total	412	-	412	-	(320)	92

As at 31 March 2017	Gross carrying amounts £m	Gross amounts offset £m	Net amount presented in statement of financial position £m	Related amounts available to be offset but not offset in statement of financial position: Financial instruments £m	Related amounts available to be offset but not offset in statement of financial position: Cash collateral received/ pledged £m	Net amount £m
Assets						
Derivative financial instruments	864	-	864	(157)	(518)	189
	864	-	864	(157)	(518)	189
Liabilities						
Derivative financial instruments	(419)	-	(419)	157	201	(61)
	(419)	-	(419)	157	201	(61)
Total	445	-	445	-	(317)	128

25. 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 23 can be met from existing cash and investments, operating cash flows and internal or external financing 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 maintaining current rating levels. 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 to 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 2018	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 3 years £m	Due 3 years and beyond £m	Total £m
Non-derivative financial liabilities					
Borrowings	(857)	(208)	(8)	(3,972)	(5,045)
Interest payments on borrowings [1]	(104)	(98)	(89)	(1,138)	(1,429)
Other non-interest bearing liabilities	(548)	(144)	-	-	(692)
Derivative financial liabilities					
Derivative contracts - receipts	430	370	65	29	894
Derivative contract - payments	(315)	(50)	(31)	(128)	(524)
Total at 31 March 2018	(1,394)	(130)	(63)	(5,209)	(6,796)

At 31 March 2017	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 3 years £m	Due 3 years and beyond £m	Total £m
Non-derivative financial liabilities					
Borrowings	(798)	(464)	(217)	(3,975)	(5,454)
Interest payments on borrowings [1]	(121)	(106)	(100)	(1,247)	(1,574)
Other non-interest bearing liabilities	(289)	(12)	-	-	(301)
Derivative financial liabilities					
Derivative contract - receipts	143	450	457	102	1,152
Derivative contract - payments	(210)	(308)	(57)	(164)	(739)
Total at 31 March 2017	(1,275)	(440)	83	(5,284)	(6,916)

[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.

25. Financial risk management (continued)

(c) Interest rate risk

Interest rate risk arises from our long-term borrowings. Borrowings issued at variable rates expose us to cash flow interest rate risk, partially offset by cash held at variable rates. Borrowings issued at fixed rates expose us 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 16 (borrowings) 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 2018 and 2017, net debt was managed using derivative instruments to hedge interest rate risk as follows:

	2018				
	Fixed rate £m	Floating rate £m	RPI £m	Other [1] £m	Total £m
Cash and cash equivalents	-	275	-	-	275
Financial investments	-	1,508	-	21	1,529
Borrowings	(1,453)	(415)	(3,167)	-	(5,035)
Pre-derivative position	(1,453)	1,368	(3,167)	21	(3,231)
Derivative effect	982	(721)	151	-	412
Net debt	(471)	647	(3,016)	21	(2,819)

	2017				
	Fixed rate £m	Floating rate £m	RPI £m	Other [1] £m	Total £m
Cash and cash equivalents	-	1,835	-	21	1,856
Borrowings	(1,891)	(535)	(3,060)	-	(5,486)
Pre-derivative position	(1,891)	1,300	(3,060)	21	(3,630)
Derivative effect	1,549	(1,117)	13	-	445
Net debt	(342)	183	(3,047)	21	(3,185)

1 Represents financial instruments which are not directly affected by interest rate risk, including investments in equity or other non-interest bearing instruments.

25. Financial risk management (continued)

(d) Currency risk

We are exposed to foreign exchange risk arising from non-sterling future commercial transactions and non-sterling recognised assets and liabilities.

Our policy for managing foreign exchange risk is to hedge contractually committed foreign currency cash flows over a prescribed minimum size. Where foreign currency cash forecasts are less certain, our policy is to hedge a proportion of the 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.

During 2018 and 2017, derivative financial instruments were used to manage foreign currency risk as follows:

	2018				
	Sterling £m	Euro £m	Dollar £m	Other £m	Total £m
Cash and cash equivalents	275	-	-	-	275
Financial investments	1,529	-	-	-	1,529
Borrowings	(3,714)	(232)	(790)	(299)	(5,035)
Pre-derivative position	(1,910)	(232)	(790)	(299)	(3,231)
Derivative effect	(874)	199	788	299	412
Net debt position	(2,784)	(33)	(2)	-	(2,819)

	2017				
	Sterling £m	Euro £m	Dollar £m	Other £m	Total £m
Financial investments	1,856	-	-	-	1,856
Borrowings	(4,015)	(226)	(906)	(339)	(5,486)
Pre-derivative position	(2,159)	(226)	(906)	(339)	(3,630)
Derivative effect	(995)	190	912	338	445
Net debt position	(3,154)	(36)	6	(1)	(3,185)

There was no significant currency exposure on other financial instruments, including trade receivables and payables, and other receivables and payables.

(e) Capital risk management

The capital structure of the Group consists of shareholders' equity, as disclosed in the consolidated statement of changes in equity, and net debt (note 22). Our objectives when managing capital are: to safeguard our ability to continue as a going concern, to remain within regulatory constraints of our regulated operating company 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 manage the capital structure as appropriate in order to achieve these objectives.

Maintaining appropriate credit ratings for our regulated company is an important aspect of our capital risk management strategy and balance sheet efficiency. We monitor our balance sheet efficiency by regulatory asset value (RAV) gearing calculated as net debt expressed as a percentage of RAV, which indicates the level of debt employed to fund our regulated business. It is compared with the level of RAV gearing indicated by Ofgem as being appropriate for our business, at around 62.5 - 65%. The RAV gearing ratio at 31 March 2018 was 58% (2017: 55%).

(f) Fair value analysis

Included in the statement of financial position are financial instruments which have been 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.

	2018				2017			
	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	769	-	-	769	1,632	-	-	1,632
Derivative financial instruments	-	634	-	634	-	864	-	864
	769	634	-	1,403	1,632	864	-	2,496
Liabilities								
Derivative financial instruments	-	(141)	(81)	(222)	-	(206)	(213)	(419)
Total	769	493	(81)	1,181	1,632	658	(213)	2,077

25. Financial risk management (continued)

(f) Fair value analysis (continued)

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.

Our level 3 derivative financial instruments include inflation linked swaps where the inflation curve is illiquid. In valuing these instruments we use in-house valuation models and obtain external valuations to support each reported fair value.

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

	2018 £m	2017 £m
At 1 April	**(213)**	(73)
Net gains/(losses) for the year [1]	**6**	(11)
Settlements	**126**	-
Reclassification into level 3 [2]	**-**	(129)
At 31 March	**(81)**	(213)

1 Gains of £3m (2017: £11m loss) are attributable to derivative financial instruments held at the end of the reporting period and have been recognised in finance costs in the income statement.

2 Sterling RPI swaps reclassified from level 2 into level 3 in the year to March 2017.

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

	2018 Income Statement £m	2017 Income Statement £m
+ 20 basis points change in LPI market curve [1]	**(32)**	(35)
- 20 basis points change in LPI market curve [1]	**31**	33

1 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

26. Sensitivities

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 each of which have been considered in isolation (i.e. 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.

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 2018 would result in an increase in the income statement of £14 million and a 10% decrease in unbilled revenue would have the equal but opposite effect.

(a) Sensitivities on areas of judgement and key sources of estimation uncertainty

The table below sets out the sensitivity analysis for each of the areas of estimation uncertainty. These estimates are those that have a significant risk of resulting in material adjustments to the carrying values of assets and liabilities in the next year.

	2018		2017	
	Income statement £m	Net assets £m	Income statement £m	Net assets £m
Pensions obligations benefit (pre-tax) [1]				
Discount rate change of 0.5% [2]	2	381	3	485
RPI rate change of 0.5% [3]	2	363	3	411
Change in long-term rate of increase in salaries change of 0.5% [4]	-	23	-	29
Change of one year to life expectancy at age 65	1	219	1	254
One year average increase in useful economic lives (pre-tax)				
Depreciation charge on property, plant and equipment	14	14	6	6
Amortisation charge on intangible assets	6	6	4	4
Environmental provision:				
10% change in estimated future cash flows	2	2	2	2
1% change in discount rate	4	4	3	3
Unbilled revenue at 31 March change of 10% (post-tax)	14	14	15	15

1 The changes shown are a change in the annual pension or other post-retirement benefit service charge and change in the defined benefit obligations.

2 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.

3 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.

4 This change has been applied to both the pre 1 April 2014 and post 1 April 2014 rate of increase in salary assumption.

Pensions and 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 assumption that were reasonably possible as at 31 March 2018. 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 change to increases to pensions in payment, increases to pensions in deferment and increases in salary is recognised.

(b) Sensitivities on financial instruments

We are further required to show additional sensitivity analysis under IFRS 7 and these are shown separately in the subsequent table due to the additional assumptions that are made in order to produce meaningful sensitivity disclosures.

Our financial instruments are sensitive to changes in market variables, being UK interest rates, the UK RPI and the Euro to Sterling exchange rate. The changes in market variables affect the valuation of our borrowings, deposits and derivative financial instruments. 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 for continuing operations:

- 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 2018 and 2017 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; and
- 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.

26. Sensitivities (continued)

(b) Sensitivities on financial instruments (continued)

	2018		2017	
	Income statement £m	Other equity reserves £m	Income statement £m	Other equity reserves £m
Financial risk (post-tax)				
UK RPI rate change of 0.5% [1]	13	-	12	-
UK interest rate changes of 0.50%	1	2	3	3

Assets and liabilities carried at fair value (pre-tax)

	2018		2017	
	Income statement £m	Net assets £m	Income statement £m	Net assets £m
10% fair value change in derivative financial instruments[2]	41	41	45	45

[1] Excludes sensitivities to LPI curve. Further details on sensitivities are provided in note 25(f).

[2] The effect of a 10% change in fair value assumes no hedge accounting.

27. Ultimate parent company

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

National Grid Gas plc's immediate parent company is National Grid Gas Holdings Limited. The ultimate parent company and controlling party is National Grid plc. Both of these companies are incorporated in Great Britain and are registered in England and Wales. National Grid plc consolidates the financial statements of National Grid Gas plc. Copies of the consolidated financial statements of National Grid plc may be obtained from the Company Secretary, 1-3 Strand, London WC2N 5EH.

28. Subsidiary undertakings, and joint ventures

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. Our structure has evolved through acquisitions as well as regulatory requirements to have certain activities within separate legal entities.

Subsidiary undertakings
The list below contains all subsidiaries included within the National Grid Gas plc Group.

	Principal activity	Holding
British Transco Capital Inc. (incorporated in the US)	Financing	100%
British Transco Finance Inc. (incorporated in the US)	Financing	100%
British Transco Finance (No. 1) Limited (incorporated in the Cayman Islands)	Financing	100%
British Transco Finance (No. 2) Limited (incorporated in the Cayman Islands)	Financing	100%
British Transco International Finance BV (incorporated in the Netherlands)	Financing	100%
National Grid Metering Limited (incorporated in England and Wales)	Gas metering services	100%

Joint ventures
The list below contains all joint ventures included within the National Grid Gas plc Group.

	Principal activity	Holding
Joint Radio Company Limited (incorporated in England and Wales)	Consultancy services	50%

Joint Radio Company Limited is based at 52 Dean Bradley House, Horseferry Road, London, SW1P 2AF.

Company accounting policies

for the year ended 31 March 2018

We are required to include the stand-alone balance sheet of our parent Company, National Grid Gas plc, under the Companies Act 2006, and the statement of changes of equity under Financial Reporting Standard 102, "The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland" ("FRS 102"). The following disclosures provide additional information to stakeholders.

A. Basis of preparation of individual financial statements under FRS 102

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

These individual financial statements of the Company have been prepared in accordance with UK Accounting Standards, including FRS 102 and the Companies Act 2006.

The individual financial statements of the Company have been prepared on a 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 comparative financial information has also been prepared on this basis.

The individual financial statements have been prepared on a going concern basis following the assessment made by the Directors as set on page 31.

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 exemption, under FRS 102 paragraph 1.12(b), from preparing a cash flow statement.

The Company has also taken advantage of the exemption, under FRS 102 paragraph 1.12 (d), from making disclosures relating to share based payments as the equivalent disclosures are included in the consolidated financial statements of the Group, and also under paragraph 1.12(e), from disclosing transactions with other members of the National Grid group of companies.

In accordance with exemptions under FRS 102 paragraph 1.12(c), 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. 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.

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

- review of residual lives, carrying values and impairment charges for other intangible assets and property, plant and equipment – notes 4 and 5.
- estimation of asset/liabilities for pensions and other post-retirement benefits – notes 13.
- valuation of financial instruments and derivatives – notes 9.
- revenue recognition and assessment of unbilled revenue.
- environmental and decommissioning provisions – note 14.

C. Disposal of Gas Distribution

As described further in note 7 of the consolidated accounts, the disposal of the Gas Distribution business completed on 1 October 2016 and as a result all assets and liabilities of UK Gas Distribution were disposed.

As Gas Distribution represents a separate major line of business, the business was classified as a discontinued operation in the consolidated income statement for the financial year 2016/17.

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. Intangible assets

Computer software is stated at cost less accumulated amortisation and accumulated impairment losses. Software is amortised over the length of period we expect to receive benefit from the asset. The principal amortisation period for software is eight years.

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

F. Tangible fixed assets

Tangible fixed assets are included in the balance sheet at their cost less accumulated depreciation. Costs include payroll costs and finance costs incurred which are directly attributable to the construction of tangible fixed assets, as well as the cost of any asset retirement obligations.

Tangible fixed assets include 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, extensions to, enhancements to, or replacement of existing assets.

Contributions received towards the cost of tangible fixed assets from customers for connections to the gas transmission and distribution networks are initially recognised as deferred income and credited to revenue once the connection has been completed. Contributions received towards the provision of ongoing access to a supply of services are recognised initially as deferred income and revenue is subsequently recognised over the period in which the service is provided. Contributions received towards the altering, diverting or relocating a tangible fixed asset are included in creditors as deferred income and credited on a straight-line basis to the profit and loss account over the estimated useful economic lives of the assets to which they relate.

Depreciation is not provided on freehold land or assets in the course of construction. Other tangible fixed assets are depreciated on a straight-line basis, at rates estimated to write off their book values over their estimated useful economic lives.

The assets' residual values are reviewed, and adjusted, if appropriate, at the end of each reporting period. The effect of any change is accounted for prospectively.

In assessing estimated useful economic lives, which are reviewed on a regular basis, consideration is given to any contractual arrangements and operational requirements relating to particular assets. Unless otherwise determined by operational requirements, the depreciation periods for the principal categories of tangible fixed assets are, in general, as shown in the following table:

Depreciation periods	Years
Freehold and leasehold properties	5 to 50
Plant and machinery:	
– Mains, services and regulating equipment	5 to 60
– Other	5 to 50
Motor vehicles and office equipment	3 to 10

G. 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, where value in use is the present value of future cash flows expected to be derived from an asset.

H. Impairment of fixed assets

Impairments of fixed assets are calculated as the difference between the carrying values of the net assets of income generating units, including where appropriate, investments, and their recoverable amounts. Recoverable amount is defined as the higher of net realisable value or estimated value in use at the date the impairment review is undertaken. Net realisable value represents the amount that can be generated through the sale of assets. Value in use represents the present value of expected future cash flows discounted on a pre-tax basis, using the estimated cost of capital of the income generating unit.

Impairment reviews are carried out if there is some indication that impairment may have occurred, or where otherwise required to ensure that fixed assets are not carried above their estimated recoverable amounts. Impairments are recognised in the profit and loss account, and, where material, are disclosed as exceptional. Impairment reversals are recognised when, in management's opinion, the reversal is permanent.

I. 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.

J. Stocks

Stocks are stated at cost less provision for deterioration and obsolescence. Cost is calculated on a weighted average basis. Where applicable, cost comprises direct materials and direct labour costs as well as those overheads that have been incurred in bringing the stocks to their present location and condition.

K. Environmental costs

Environmental costs, based on discounted future estimated expenditures expected to be incurred, are provided for in full. The unwinding of the discount is included within the profit and loss account as a financing charge.

L. Revenue

Revenue represents the sales value derived from the transmission and distribution of gas and the provision of gas metering services during the year, including an assessment of services provided, but not invoiced as at the year end. It excludes value added tax and intra-company sales.

Where revenue for the year exceeds the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over-recovery, a liability for the over- recovery is not recognised as such an adjustment to future prices relates to the provision of future services. Similarly, an asset is not recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under- recovery.

M. Pensions

The Company's employees are members of either the defined benefit National Grid UK Pension Scheme or the National Grid YouPlan defined contribution trust.

For defined benefit pension schemes, the regular service cost of providing retirement benefits to employees during the period, together with the cost of any benefits relating to past service, are recognised within operating costs.

The interest cost is calculated by applying the discount rate to the net balance of the defined benefit obligation and the fair value of plan assets. This cost is recognised in profit or loss account within net interest.

The present value of the defined benefit obligation, less the fair value of the assets of the scheme at the reporting date, is recognised on the balance sheet.

The difference between the actual and expected returns on scheme assets and the experience gains or losses arising on scheme liabilities, together with gains or losses arising from changes in actuarial assumptions, are charged or credited to other comprehensive income.

N. Leases

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership. Operating lease payments are charged to the profit and loss account on a straight-line basis over the term of the lease.

O. Financial instruments

The Company's accounting policies under FRS 102 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 11, 13, 14, 15, 16 and 17 to the consolidated financial statements. The Company is taking the exemption for financial instruments disclosures, because IFRS 7 disclosures are given in the notes to the consolidated financial statements.

P. 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 11 to the consolidated financial statements.

Q. Share-based payments

National Grid issues equity-settled share-based payments to certain employees of the Company. Equity-settled share-based payments are measured at fair value at the date of grant, based on an estimate of the number of shares that will eventually vest. This fair value is recognised on a straight-line basis over the vesting period, as an operating cost and an increase in equity. Payments made by the Company to National Grid in respect of share-based payments are recognised as a reduction in equity.

R. Parent Company guarantees

The Company has guaranteed the repayment of the principal sum, any associated premium and interest on specific loans due from certain subsidiary undertakings 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.

S. Environmental provision

The environmental provision is calculated on a discounted basis and represents the estimated environmental restoration and remediation costs relating to a number of sites owned and managed by the Company.

T. Emission allowances

Emission allowances, which relate to the emissions of carbon dioxide, are recorded as an intangible asset within current assets and are initially recorded at cost, and subsequently at the lower of cost and fair value less costs to sell. For allocations of emission allowances granted by the UK Government, cost is deemed to be equal to fair value at the date of allocation.

Receipts of such grants are treated as deferred income and are recognised in the income statement in the period in which carbon dioxide emissions are made. A provision is recorded in respect of the obligation to deliver emission allowances and charges are recognised in the income statement in the period in which carbon dioxide emissions are made.

U. Dividends

Interim dividends are recognised when they are paid to the Company's shareholders. Final dividends are recognised in the financial year in which they are approved.

Company balance sheet

as at 31 March

	Notes	2018 £m	2017 £m
Fixed assets			
Intangible assets	4	**107**	125
Tangible assets	5	**4,433**	4,358
Investments	6	**17**	17
		4,557	4,500
Current assets			
Cash and cash equivalents		**274**	-
Stocks and other current assets	7	**21**	20
Debtors (amounts falling due within one year)	8	**956**	381
Debtors (amounts falling due after more than one year)	8	**3,521**	3,435
Derivative financial instruments (amounts falling due within one year)	9	**43**	51
Derivative financial instruments (amounts falling due after more than one year)	9	**591**	813
Investments		**884**	1,836
Post employment benefits pension asset	13	**412**	45
		6,702	6,581
Creditors (amounts falling due within one year)	10	**(1,725)**	(1,594)
Net current assets		**4,977**	4,987
Total assets less current liabilities		**9,534**	9,487
Creditors (amounts falling due after more than one year)	11	**(4,363)**	(4,949)
Provisions for liabilities	14	**(652)**	(668)
Net assets		**4,519**	3,870
Capital and reserves			
Share capital	15	**45**	45
Share premium account		**204**	204
Cash flow hedge reserve		**(10)**	(7)
Capital redemption reserve		**1,332**	1,332
Profit and loss account		**2,948**	2,296
Total shareholders' equity		**4,519**	3,870

The Company financial statements set out on pages 95 to 103 were approved by the Board of Directors and authorised for issue on 21 June 2018. They were signed on its behalf by:

Nicola Shaw Chair

Alan Foster Director

National Grid Gas plc
Registered number: 2006000

Company statement of changes in equity

for the years ended 31 March

	Share capital £m	Share premium account £m	Profit and loss account £m	Cash flow hedge reserve £m	Capital redemption reserves £m	Total shareholders' equity £m
As at 1 April 2016	45	204	5,815	(61)	1,332	7,335
Profit for the year	-	-	4,464	-	-	4,464
Total other comprehensive loss for the year	-	-	111	54	-	165
Total comprehensive income/(loss) for the year	-	-	4,575	54	-	4,629
Equity dividends	-	-	(8,100)	-	-	(8,100)
Share-based payments	-	-	7	-	-	7
Tax on share-based payments	-	-	(1)	-	-	(1)
As at 31 March 2017	45	204	2,296	(7)	1,332	3,870
Profit for the year	-	-	374	-	-	374
Total other comprehensive income for the year	-	-	274	(3)	-	271
Total comprehensive income for the year	-	-	648	(3)	-	645
Share-based payments	-	-	4	-	-	4
At 31 March 2018	**45**	**204**	**2,948**	**(10)**	**1,332**	**4,519**

The cash flow hedge reserve 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 £8m (2017: £5m), and the remainder released with the same maturity profile as borrowings due after more than one year.

Other reserves comprise the capital redemption reserve arising from the refinancing and restructuring of the Lattice Group in 1999. It represents the amount of the reduction in the share capital of the Company as a consequence of that restructuring. As the amounts included in other reserves are not attributable to any of the other classes of equity presented, they have been disclosed as a separate classification of equity.

The Company is prohibited from declaring a dividend or other distribution unless it has certified that it is in compliance in all material respects with certain regulatory obligations, including a requirement to ensure it has sufficient financial resources and facilities to enable it to carry on its business and a requirement to use all reasonable endeavours to maintain an investment grade credit rating.

The Company has not presented its own profit and loss account and related notes as permitted by section 408 of the Companies Act 2006. The Company's profit after taxation was £374m (2017: £4,464m).

For further details of dividends paid and payable to shareholders, refer to note 6 in the consolidated financial statements.

Notes to the Company financial statements

1. Auditors' remuneration

Auditors' remuneration in respect of the Company is set out below:

	2018 £m	2017 £m
Audit services		
Audit fee of Company	0.4	0.5
Other services		
Fees payable to the company's auditors for audit-related assurance services	0.5	0.2
Other non audit services	-	6.9

Fees payable to the Company's auditors for audit-related assurance services represent fees payable for services in relation to engagements which are required to be carried out by the auditors. Other non-audit services in the prior year primarily include amounts incurred in respect of the disposal of a majority stake in the Gas Distribution business (vendor due diligence and separation support). These fees have been subject to approval by the Audit Committee of National Grid plc.

2. Number of employees, including Directors

	2018 Monthly Average number	2017 Monthly Average number
Gas Transmission	986	916
Other[1]	752	829
Total continuing operations	1,738	1,745
Discontinued operations [2]	-	3,651

1 Other comprises employees working in shared services supporting the Gas Transmission business

2 Discontinued operations for 2017 represents the average number of employees employed for the six months prior to the Gas Distribution business being hived out on 1st October 2016.

3. Key management compensation

Key management comprises the Board of Directors of the Company together with those Executive Directors of National Grid plc who have managerial responsibility for National Grid Gas plc. Details of key management personnel compensation are provided in note 2(d) to the consolidated financial statements.

4. Intangible assets

	Software £m
Cost at 1 April 2017	324
Additions	16
Reclassifications [1]	2
Disposals	(20)
Transfers[2]	(9)
Cost at 31 March 2018	313
Accumulated amortisation at 1 April 2017	(199)
Amortisation charge for the year	(27)
Disposals	20
Accumulated amortisation at 31 March 2018	(206)
Net book value at 31 March 2018	**107**
Net book value at 31 March 2017	125

1 Represents amounts transferred from tangible assets (see note 5)

2 Transfers represents assets transferred to a fellow group undertaking.

5. Tangible assets

	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 2017	361	8,056	269	226	8,912
Additions	6	123	188	6	323
Disposals[1]	(3)	(47)	(8)	(11)	(69)
Reclassifications[2]	(69)	108	(46)	5	(2)
Transfers[3]	(4)	-	-	(1)	(5)
Cost at 31 March 2018	291	8,240	403	225	9,159
Accumulated depreciation at 1 April 2017	(213)	(4,145)	-	(196)	(4,554)
Depreciation charge for the year	(20)	(187)	-	(8)	(215)
Disposals[1]	3	32	-	11	46
Reclassifications[2]	48	(48)	-	-	-
Impairment	-	(3)	-	-	(3)
Accumulated depreciation at 31 March 2018	(182)	(4,351)	-	(193)	(4,726)
Net book value at 31 March 2018	**109**	**3,889**	**403**	**32**	**4,433**
Net book value at 31 March 2017	148	3,911	269	30	4,358

1 Disposals includes £20m of nil net book value assets written off

2 Represents amounts transferred between categories and also to intangible assets (see note 4).

3 Transfers represents assets transferred to a fellow group understaking

The cost of tangible fixed assets at 31 March 2018 included £239m (2017: £229m) relating to interest capitalised. Interest was capitalised at the rate of 4.8% (2017: 3.2%)

The net book value of land and buildings comprised:

	2018 £m	2017 £m
Freehold	53	88
Short leasehold (under 50 years)	56	60
	109	148

Included within creditors (amounts falling due within one year) and creditors (amounts falling due after more than one year) are contributions to the cost of tangible fixed assets amounting to £nil (2017: £nil) and £32m (2017: £31m) respectively.

6. Investments

	Shares in subsidiary undertakings £m
Cost and net book value at 31 March 2017 and 31 March 2018	17

The names of the subsidiary undertakings and joint ventures are included in note 28 to the consolidated financial statements.

The Directors believe that the carrying value of the investments is supported by their underlying net assets.

7. Stocks and other current assets

	2018 £m	2017 £m
Raw materials and consumables	17	18
Other current assets - emission allowances	4	2
	21	20

8. Debtors

	2018 £m	2017 £m
Amounts falling due within one year:		
Trade debtors	106	85
Amounts owed by fellow subsidiary undertakings	669	21
Other debtors	11	10
Accrued income	144	147
Prepayments	26	118
	956	381
Amounts falling due after more than one year:		
Amounts owed by immediate parent undertaking	3,427	3,426
Other debtors	94	9
	3,521	3,435
Total debtors	4,477	3,816

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

9. Derivative financial instruments

The fair values of derivative financial instruments are:

	2018			2017		
	Assets £m	Liabilities £m	Total £m	Assets £m	Liabilities £m	Total £m
Amounts falling due within one year	43	(65)	(22)	51	(185)	(134)
Amounts falling due after more than one year	591	(157)	434	813	(234)	579
	634	(222)	412	864	(419)	445

For each class of derivative the notional contract amounts[1] are as follows:

	2018 £m	2017 £m
Interest rate swaps	(2,473)	(3,173)
Cross-currency interest rate swaps	(751)	(728)
Foreign exchange forward contracts	(3)	(56)
Inflation linked swaps	(696)	(784)
	(3,923)	(4,741)

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

For details on fair value techniques and assumptions, refer to note 25 to the consolidated financial statements.

10. Creditors (amounts falling due within one year)

	2018 £m	2017 £m
Derivative financial instruments (note 9)	65	185
Borrowings (note 12)	1,017	953
Trade creditors	106	136
Amounts owed to fellow subsidiary undertakings	272	97
Corporation tax	26	9
Other taxation and social security	56	70
Other creditors	154	44
Deferred income	29	100
	1,725	1,594

11. Creditors (amounts falling due after more than one year)

	2018 £m	2017 £m
Derivative financial instruments (note 9)	**157**	234
Borrowings (note 12)	**4,135**	4,636
Other creditors	**32**	11
Accruals and deferred income	**39**	68
	4,363	4,949

Deferred income mainly comprises contributions to capital projects.

12. Borrowings

The following table analyses the Company's total borrowings:

	2018 £m	2017 £m
Amounts falling due within one year:		
Bank loans and overdrafts	**417**	539
Bonds	**259**	303
Borrowings from subsidiary undertakings	**340**	110
Other loans	**1**	1
	1,017	953
Amounts falling due after more than one year:		
Bank loans	**508**	490
Bonds	**2,958**	3,200
Borrowings from subsidiary undertakings	**500**	757
Other loans	**169**	189
	4,135	4,636
Total borrowings	**5,152**	5,589

	2018 £m	2017 £m
Total borrowings are repayable as follows:		
Less than 1 year	**1,017**	953
In 1 - 2 years	**212**	470
In 2 - 3 years	**8**	226
In 3 - 4 years	**814**	8
In 4 - 5 years	**740**	890
More than 5 years by instalments	**51**	51
More than 5 years, other than by instalments	**2,310**	2,991
	5,152	5,589

The notional amount outstanding of the Company's debt portfolio at 31 March 2018 was £4,997m (2017: £5,326m).

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

13. Pensions

Substantially all the Company's employees are members of either the defined benefit National Grid UK (Section B) pension scheme or the National Grid YouPlan defined contribution trust. The relevant information for both these schemes is included in note 19 to the consolidated financial statements.

The disclosures required by FRS 102 are the same as those required by IAS 19 (revised) and are provided in note 19 to the consolidated financial statements.

Amounts recognised in the balance sheet of the Company are as follows:

	2018 £m	2017 £m
Present value of funded obligations	(5,411)	(5,806)
Fair value of plan assets	5,823	5,851
	412	45
Present value of unfunded obligations	-	-
Net pension asset	412	45
Changes in the present value of defined benefit obligations (including unfunded obligations)		
Opening defined benefit obligations	(5,806)	(5,878)
Current service cost	(26)	(5)
Interest cost	(136)	(37)
Remeasurement of the defined benefit obligation	336	51
Special termination cost - redundancies	-	(1)
Expense payments	3	-
Benefits paid	218	64
Closing defined benefit obligations	(5,411)	(5,806)
Changes in the fair value of scheme assets		
Opening fair value of scheme assets	5,851	5,789
Interest income on plan assets	137	36
Return on plan assets greater than discount rate	(6)	83
Administration costs	(3)	(1)
Employer contributions	62	8
Benefits paid	(218)	(64)
Closing fair value of scheme assets	5,823	5,851

14. Provisions

	Decommissioning £m	Environmental £m	Restructuring £m	Deferred taxation £m	Other £m	Total £m
At 1 April 2017	118	23	5	379	143	668
Charged to profit and loss	-	-	2	18	6	26
Reclassifications[1]	-	-	-	-	34	34
Transferred to reserves	-	-	-	57	-	57
Released	(11)	-	(3)	-	(33)	(47)
Utilised	(4)	-	-	-	(84)	(88)
Unwinding of discount	1	1	-	-	-	2
At 31 March 2018	**104**	**24**	**4**	**454**	**66**	**652**

1 Reclassification of £34m relates to an in year reclassification of the prior year Crop and Quarry accrual to provision

Decommissioning provision

The decommissioning provision represents expenditure relating to the demolition of gas and LNG storage facilities expected to be incurred until 2026.

During October 2016, following the sale of the Gas Distribution business, the company sold 78 surplus land sites to a number of fellow National Grid Group undertakings, recognising a gain on disposal of £109 million. A legal agreement was entered into with these National Grid Gas Group companies to demolish the non-operational gas holders on these sites, creating a constructive obligation for the Company.

Environmental provision

The environmental provision represents the estimated restoration and remediation costs relating to old gas manufacturing sites owned by the Company (discounted using a real rate of 1.0%). Cash flows are expected to be incurred between 2018 and 2075.

A number of uncertainties affect the calculation of the provision including the impact of regulation, the accuracy of the site surveys, unexpected contaminants, transportation costs, the impact of alternative technologies and changes in the discount rate. The provision incorporates our best estimate of the financial effect of these uncertainties, but future material changes in any of the assumptions could materially impact the calculation of the provision. The undiscounted amount of the provision at 31 March 2018 was £28m (2017: £27m), being the undiscounted best estimate of the liability having regard to these uncertainties.

Restructuring provision

The restructuring provision principally related to business reorganisation costs and is expected to be incurred until 2019.

Deferred taxation

Deferred taxation comprises:

	2018 £m	2017 £m
Accelerated capital allowances	386	382
Other timing differences	68	(3)
	454	379

Other provisions

Other provisions at 31 March 2018 include £40m (2017: £134m) in respect of business set up costs and business restructuring costs. We expect the majority of this provision to be utilised within one year. Unused amounts reversed of £33m principally represents amounts released from the crop and quarry provision of £14m and amounts released in respect of business set up and restructuring costs of £17m. Amounts utilised of £84m principally relates to the utilisation of provisions in respect of business set up and restructuring costs.

15. Share capital

	Number of shares 2018 millions	Number of shares 2017 millions	2018 £m	2017 £m
At 31 March 2017 and 2018 - ordinary shares of $1^{2}/_{15}$p each Allotted, called-up and fully paid	3,944	3,944	45	45

16. Commitments and contingencies

(a) Future capital expenditure

	2018 £m	2017 £m
Contracted for but not provided	299	372

(b) Operating lease commitments

	2018 £m	2017 £m
Amounts due:		
Not later than one year	6	7
Later than one year and not later than five years	14	19
Later than five years	5	9
	25	35

(c) Other commitments and contingencies

The value of other commitments, contingencies and guarantees at 31 March 2018 amounted to £89m (2017: £31m), including energy purchase commitments amounting to £8m (2017: £25m). 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 (i.e. normal purchase, sale or usage) and hence are accounted for as ordinary purchase contracts.

(d) Parent Company loan guarantees on behalf of subsidiary undertakings

The Company has guaranteed the repayment of principal sums, any associated premium and interest on specific loans due from its subsidiaries to third parties. At 31 March 2018, the sterling equivalent amounted to £1,084m (2017: £992m).

(e) Litigation and claims

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.

17. Related parties

The following material transactions are with a former subsidiary of the Company which is not wholly owned by National Grid plc and are in the normal course of business. Other related party transactions are not disclosed in accordance with the exemptions available under FRS 102.

	2018 £m	2017 £m
Goods and services supplied	223	78
Services received	36	16
Amounts receivable at 31 March	50	13
Amounts payable at 31 March	381	19

Amounts payable or receivable are ordinarily settled one month in arrears. No amounts have been provided at 31 March 2018 (2017: £nil) and no expense has been recognised during the year (2017: £nil) in respect of bad or doubtful debts from the above related party transactions.

Glossary and definitions

References to the 'Company', 'we', 'our', and 'us', refer to National Grid Gas plc itself or to National Grid Gas plc and its subsidiaries collectively, depending on context.

EU
European Union

FRS
UK Financial Reporting Standard

GAAP
Generally accepted accounting principles

GHG
Greenhouse Gas

GW
Gigawatt, 10^9 watts

GWh
Gigawatt hours

HSE
Health and Safety Executive

IAS
International Accounting Standard

IASB
International Accounting Standards Board

IFRIC
International Financial Reporting Standards Interpretations Committee

IFRS
International Financial Reporting Standard

KPI
Key Performance Indicator

LNG
Liquefied natural gas

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

National Grid
National Grid plc, the ultimate parent Company of National Grid Gas plc and its controlling party

Ofgem
The Office of Gas and Electricity Markets

tonnes CO_2 equivalent
Measure of greenhouse gas emissions in relation to the impact of carbon dioxide

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

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

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

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

RPI
UK Retail Prices Index

STEM
Science, Technology, Engineering & Mathematics

TW
Terawatt, 10^{12} watts

TWh
Terawatt hours

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