# Annual Report and Accounts 2014/15
# National Grid Electricity Transmission plc

Company number 2366977

# Contents

# Overview

## About National Grid Electricity Transmission plc

National Grid Electricity Transmission plc (National Grid Electricity Transmission) is a subsidiary of National Grid plc (National Grid), based in the UK, where we own and operate regulated electricity transmission networks. We play a vital role in connecting millions of people safely, reliably and efficiently to the energy they use.

The overall governance of National Grid Electricity Transmission is the responsibility of its Board of Directors. Our Directors are listed on page 29.

More information on the management structure of National Grid can be found in the National Grid Annual Report and Accounts 2014/15 and on National Grid's website at www.nationalgrid.com.

### Financial highlights

| | 2014/15 £m | 2013/14 £m | Percentage change |
|---|---|---|---|
| Operating profit | **1,227** | 1,018 | 21% |
| Adjusted operating profit[1] | **1,171** | 1,078 | 9% |
| Cash generated from operations | **1,648** | 1,387 | 19% |
| Regulated assets[2] | **11,339** | 10,871 | 4% |
| Return on equity | **14.0%** | 12.4% | 13% |

1. See page 12 for further details.
2. See page 5 for further details.

### Non-financial highlights

| | 2014/15 | 2013/14 |
|---|---|---|
| Number of employees | **3,270** | 3,324 |
| Network reliability | **99.99999%** | 99.99999% |

### Our principal operations

We own and maintain the high-voltage electricity transmission network in England and Wales, balancing supply with demand on a minute-by-minute basis. We are also the system operator for the high voltage electricity transmission networks in Scotland. See pages 18 and 19 for further details.

# Strategic Report

## Operating environment

### Economic environment

The UK economy has been recovering steadily in the past year, with 2.6% economic growth, falling unemployment and falling inflation. Growth in the fourth quarter of 2014, however, dropped to 0.5% as sluggish Eurozone growth depressed exports and wider geo-political events increased the perceived risk of investment. Below, we highlight our main market drivers and the impact they have on our business.

| Market driver | Impact |
|---|---|
| Changing energy mix<br>**Changing fuel costs and environmental programs are affecting traditional electricity generation**<br><br>In February 2015 DECC announced the results of the first Contracts for Difference (CfD) auction allocation rounds, with wind technology making up the bulk of contracted generation. Continued support for solar PV through Feed in Tariffs (FiTs) and the Renewables Obligation contributed to growth in installed solar PV.<br><br>Older fossil fuel plants continue to face the challenge of environmental regulations while the new nuclear plant at Hinckley received State Aid approval from the European Commission in October 2014. | **This could lead to significant network investment opportunities**<br><br>Increasing deployment of large-scale wind, large-scale solar PV and nuclear will require more investment in transmission networks to connect new plant and reinforce the network. Variable output from solar PV and wind makes balancing demand and supply more challenging.<br><br>More interconnection between the UK and adjacent European markets will deliver net benefits to the UK. |
| Energy policy<br>**Sustainability, security of supply and affordability underpin EU policy**<br><br>Against a difficult economic and financial background, the EU's energy policy is underpinned by sustainability, security of supply and affordability. In October 2014 the EU heads of state agreed the EU's 2030 Climate Change and Energy Framework. This includes a 40% reduction target for carbon emissions, alongside other objectives for renewables, energy efficiency and interconnections.<br><br>Negotiations for a new international agreement on climate change continued at the twentieth session of the Conference of Parties (COP20) in Lima in December 2014. Nations are looking to the Paris worldwide conference in 2015 as the next opportunity to work out a new climate change deal.<br><br>Finally, the creation of a 'genuine energy union' was highlighted as one of the main priorities of the new European Commission, which took office in November 2014. | **Policy decisions can affect our investment needs and compliance obligations**<br><br>Greater levels of market integration, interconnection and renewable generation are fundamental to achieving the EU's policy objectives.<br><br>While European developments present challenges, the significant level of investment required will create opportunities for growth. For example, potential future interconnector opportunities include connections between the UK and France, Ireland, Denmark and Iceland. Such opportunities would help the EU achieve its interconnection targets. |
| **Energy policies are attracting investment and there is significant political focus on reducing costs for consumers**<br><br>Energy policy continues to evolve from the Climate Change Act 2008, which commits the Government to reducing greenhouse gas emissions to at least 80% lower than a 1990 baseline by 2050. The Energy Act 2013 implements the main aspects of Electricity Market Reform (EMR), and puts in place measures to attract the investment needed. The run up to the General Election in May 2015 saw a sharp focus on the costs of energy and the competitiveness of energy markets. | **National Grid Electricity Transmission is central to the delivery of EMR and active on driving down costs**<br><br>National Grid Electricity Transmission has been performing its role as delivery body for the Government on EMR.<br><br>The focus on the cost of energy is important to National Grid. We are working hard to highlight to our stakeholders how the RIIO regulatory framework is helping us to reduce costs for consumers while creating incentives for vital investment. |

| Market driver | Impact |
|---|---|
| **Regulation** | |
| **Infrastructure investment needs must be balanced with affordability**<br><br>Ofgem acknowledge that there is a significant need for infrastructure investment. However, affordability continues to be a primary concern.<br><br>Severe weather in recent years has also highlighted the potential need for additional investment in network resilience. Ofgem and policymakers are beginning to ask utilities to put plans in place to strengthen their networks ability to withstand the effects of severe weather. | **We must accommodate customers' cost concerns and also provide safe, up-to-date systems**<br><br>We must accommodate our customers' affordability concerns while fulfilling our obligations to provide safe and reliable services and upgrading our systems. Investment is required for new connections, to meet the challenges of changing supply and demand patterns, and to replace ageing infrastructure. |
| **Ofgem wants greater efficiency and innovation**<br><br>The regulatory focus during the year has been on the new RIIO price controls which give greater focus to incentives and innovation than the previous regulatory regime.<br><br>We continue to be engaged in the debate on the regulatory approach to electricity transmission investment, stemming from the projected increase in offshore wind generation and interconnection. | **This is driving them to favour more market competition**<br><br>Competition is already in place for offshore development and Ofgem has stated its intent to retain the option of using greater competition for certain large onshore projects. |
| **Ofgem is reviewing the arrangements for planning and delivering Britain's transmission networks**<br><br>We are facing new challenges from an ageing infrastructure and a changing energy mix. Technical developments and innovation also mean that there could be opportunities to coordinate and integrate those investments.<br><br>The Integrated Transmission Planning and Regulation (ITPR) project is looking at these long-term challenges to assess whether the regulatory arrangements currently in place are sufficient to ensure coordination and efficiency in the future planning of the electricity transmission. | **We need to make sure the network is planned in an economic, efficient and coordinated way**<br><br>Ofgem has proposed enhancing our role as System Operator (SO) so that the SO has a greater role in system planning. No organisation is currently responsible for taking an overarching view of system development, so opportunities for coordination can potentially be missed. We are working with Ofgem to develop the framework for how the system will be planned and how assets will be managed. |
| **Innovation and technology** | |
| **Performance improvements and cost declines have led to continued growth in new technologies**<br><br>Distributed generation of solar power has grown significantly due to price declines and tax incentives.<br><br>The UK hit a record high for wind generation in 2014 of 28 terawatt hours (TWh), 15% greater than the previous year. | **Further investment in electric distribution network may be necessary to integrate these new technologies**<br><br>Investment in renewable energy continues to grow. Regulatory proceedings are underway to enhance the value of distributed resources to the grid and give customers more control over their energy use.<br><br>These could require significant network investment in order to integrate new and variable resources and provide customers with more information on their usage. |

# What we do - Electricity

The electricity industry connects generation sources to homes and businesses through transmission and distribution networks. Companies that pay to use transmission networks buy electricity from generators and sell it to consumers.

The UK electricity industry has five main sectors.

## 1. Generation

Generation is the production of electricity from fossil fuel and nuclear power stations, as well as renewable sources such as wind and solar. We do not own or operate any electricity generation.

## 2. Interconnectors

Transmission grids are often interconnected so that energy can flow from one country or region to another. This helps provide a safe, secure, reliable and affordable energy supply for citizens and society across the region. Interconnectors also allow power suppliers to sell their energy to customers in other countries.

Great Britain is linked via interconnectors with France, Ireland, Northern Ireland and the Netherlands. National Grid owns part of the interconnectors with France and the Netherlands. It is also now entering the construction phase for two new interconnectors, between the UK and Belgium and Norway.

National Grid sells capacity on its UK interconnectors through auctions.

## 3. Transmission

Transmission systems generally include overhead lines, underground cables and substations. They connect generation and interconnectors to the distribution system.

We own and operate the transmission network in England and Wales. We operate but do not own the Scottish networks.

National Grid is also working in a joint venture with Scottish High Power Transmission to construct an interconnector to reinforce the UK Transmission system between Scotland and England and Wales.

## 4. Distribution

Distribution systems carry lower voltages than transmission systems over networks of overhead lines, underground cables and substations. They take over the role of transporting electricity from the transmission network, and deliver it to consumers at a voltage they can use.

We do not own or operate electricity distribution networks.

## 5. Supply

The supply of electricity involves the buying of electricity and selling it on to customers. It also involves customer services, billing and the collection of customer accounts.

We do not sell electricity to consumers.

## System operator

As System Operator (SO) for England and Wales, we coordinate and direct electricity flows onto and over the transmission system, balancing generation supply and user demand. Where necessary, we pay sources of supply and demand to increase or decrease their generation or usage.

We have the same role for the two high voltage electricity transmission networks in Scotland and are also the SO for the offshore electricity transmission regime.

Our charges for SO services in the UK are subject to a price control approved by Ofgem. System users pay us for connection, for using the system and balancing services.

As electricity transmission SO, our price control includes incentives to minimise the costs and associated risks of balancing the system through buying and selling energy, as well as procuring balancing services from industry participants.

# What we do - Regulation

Our business operates as a regulated monopoly. We have one economic regulator for our business, Ofgem. The regulator safeguards customers' interests by setting the level of revenues we are allowed to recover, so that 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 Electricity Act 1989, as amended (the Act), requires us to develop, maintain and operate economic and efficient networks and to facilitate competition in the supply of electricity in Great Britain. It also gives us statutory powers, such as the right to bury our cables under public highways and the ability to use compulsory powers to purchase land to enable the conduct of our business.

Ofgem has established price control mechanisms that set the amount of revenue that can be earned by our business. Price control regulation is designed to ensure our interests, as a monopoly, are balanced with those of our customers. Ofgem allows us to charge reasonable, but not excessive, prices giving us a future level of revenue sufficient to meet our statutory duties and licence obligations, and also to make a reasonable return on our investment.

The price control includes a number of mechanisms to achieve its objectives, including financial incentives designed to encourage us to: continuously improve the cost and effectiveness of our services; manage and operate our networks efficiently; deliver high quality services to our customers and wider stakeholder community; and invest in the development of the network in a manner that ensures long-term security of supply.

Our business operates under two separate price controls. These comprise of one covering our role as Transmission Owner (TO) and the other for our role as System Operator (SO). While both price controls may have differing terms, they are based on a consistent regulatory framework.

The value of our regulated assets is calculated based on the terms of our regulatory agreement. The value of regulated assets is also increased for inflation.

Allowed revenue is calculated based on a number of factors:

**Depreciation of regulated assets** – the value of regulated assets is depreciated over an anticipated lifespan. The amount of depreciation is included in our allowed revenue, which represents the repayment of the amount we have invested in the asset.

**Return on equity and cost of debt** – regulated assets are funded through debt or equity. Our regulatory agreement set this ratio. The equity portion earns a 'return on equity'. This represents the profit we can earn on our investment in regulated assets. The debt portion earns an allowance based on the cost of debt (interest costs).

Ofgem use an external benchmark interest rate to incentivise us to raise debt efficiently. The benchmark interest method also provides an opportunity to outperform our regulatory allowance.

**Cost of service** – in establishing our regulatory agreement, Ofgem consider what costs an efficiently run company would incur to operate and maintain our networks. They vary and examples can include costs relating to employees, office rental, IT systems and taxes.

Ofgem have different approaches to determining what is considered an efficient or prudent cost and this may be different to the actual costs we incur.

**Investment in network assets** – we are given a cost allowance to make necessary investments in the networks. These investment costs allowed by the regulator are linked to the outputs delivered by the networks.

**Performance against incentives** – our price controls include incentives that are designed to encourage specific actions, such as reducing greenhouse gas emissions.

Outperforming against incentive targets can increase our allowed revenues in the current year or a future year. Failing to achieve certain minimum targets may lead to a reduction in our allowed revenue.

A further incentive mechanism enables customers and our ultimate shareholders to share the difference between allowed and actual costs via adjustments to revenue.

**Timing** – our regulated revenue entitlements are set based on our regulatory price controls. We use forecast energy volumes that we expect to deliver to set the billing tariff. Where there is a difference between the actual and estimated energy volumes, the amount of revenue we collect will be different.

For more information on timing see page 15.

## RIIO price controls

In 2013, Ofgem introduced a new regulatory framework called RIIO (revenue = incentives + innovation + outputs) that became effective on 1 April 2013 and lasts for eight years.

**How is revenue calculated?**

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 input to these decisions. The clarity around outputs should lead to greater transparency of our performance in delivering them.

The five key 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 coming 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. Using information submitted by us along with independent assessments, Ofgem determines the efficient level of expected costs necessary to deliver them. Under RIIO this is known as totex, short for total expenditure.

A number of assumptions are necessary in setting these outputs, such as certain prices or the volumes of work that will be needed. As a result, to protect us and our customers from windfall gains and losses, there are a number of uncertainty mechanisms within the RIIO framework that can result in adjustments to totex if actual prices or 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, i.e. the under or over-spend is shared between us and customers through an adjustment to allowed revenues in a future year. This sharing factor provides an incentive for us to provide the outputs efficiently as we are able to keep a portion of the savings, with the remainder benefiting our customers.

This sharing factor is one of the ways that RIIO has given innovation more prominence. Innovation includes traditional areas such as new technologies, as well as the broader challenge of finding new ways of working to deliver outputs more efficiently. This broader challenge will have an impact on everyone in our business.

Totex is then split between fast and slow money, based on specified percentages. Fast money represents the amount of totex that we are able to recover in the current year. Slow money is added to our regulated asset value (RAV). In addition to fast money, in each year we are allowed to collect against depreciation costs and earn an allowed return on our RAV.

We are also permitted to collect additional revenues related to non-controllable costs and incentives.

The incentive mechanisms can increase or decrease our allowed revenue and result from our performance against various measures related to our outputs. RIIO includes incentive mechanisms as a way to provide further incentives to align our objectives with those of our customers and other stakeholders. For example, performance against our customer satisfaction targets can have a positive or negative effect of up to 1% of allowed annual revenues. Incentives will normally affect our revenues two years after the year of performance.

**Key RIIO financial metrics**

Some of the key financial metrics are included below:

| | |
|---|---|
| Cost of equity (post-tax real) | 7.0% |
| Cost of debt (pre-tax real) | iBoxx 10 year simple trailing average index (2.92% for 2013/14) |
| Notional gearing | 60.0% |
| Vanilla WACC* | 4.55% |

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

| | Transmission Operator | System Operator |
|---|---|---|
| Fast | 15.00% | 72.10% |
| Slow | 85.00% | 27.90% |
| Sharing | 46.89% | 46.89% |

*For more information on RIIO, including incentive mechanisms, please see the relevant investor fact sheets on the Investor Relations section of our website.*

# Our business model

## Our business

Our strategy is to be a recognised leader in the development and operation of safe, reliable and sustainable energy infrastructure, to meet the needs of our customers and communities.

We own and operate electricity transmission infrastructure in the UK. Our principal operation is UK Electricity Transmission.

We aim to maintain a clear and consistent strategy over the long term to provide consistent levels of service to our customers and communities.

Our transmission business operates as a regulated monopoly. Regulators safeguard customers' interests by setting the level of charges we are allowed to pass on. We have one regulator for our business: Ofgem.

## Our value proposition

We are a long-term, asset-based business. Our operations are regulated, which means we create value for our stakeholders through predictable revenue streams and cash flows.

### Revenue

Most of our revenue is set in accordance with our regulatory agreements. This is referred to as our 'allowed revenue' and is calculated based on a number of factors. These include:

- investment in network assets;
- performance against incentives;
- return on equity and cost of debt; and
- customer satisfaction scores.

Our allowed revenue gives us a level of certainty over future revenues if we continue to meet safety and reliability targets, as well as the efficiency and innovation targets included in the RIIO licence agreements.

You can find more information about calculating our allowed revenue under our regulatory agreement on pages 5 and 6.

### Investment

We invest efficiently in our networks to deliver strong regulated asset growth over the long term. This allows us to continue generating revenue growth and growth in our regulated asset base. This in turn generates additional cash flows and allows us to continue reinvesting in our networks and providing sustainable dividends to our ultimate shareholders.

This approach is critical to the sustainability of our business. By challenging our investment decisions, we continue to deliver reliable, cost-effective networks that benefit our customers. The way in which our investment is funded is also an important part of our business. The long-term, sustainable nature of our assets and our credit ratings help us secure efficient funding from a variety of sources.

### Cash flow

Our ability to convert revenue to cash is an important factor in the ongoing reinvestment in our business. Securing low-cost funding, carefully managing our cash flows and efficient development of our networks are essential to maintaining strong sustainable returns for our ultimate shareholders. Cash generation is underpinned by agreeing appropriate regulatory arrangements.

## Our stakeholders

Our stakeholders include customers, the communities in which we operate, Government and Ofgem.

We create value for our customers and communities by:

- operating safely, reliably and sustainably;
- focusing on affordability to reduce the impact on customer bills;
- delivering essential services that meet the needs of our customers;
- providing emergency services; and
- engaging with the communities in which we operate.

We create value for our shareholders by:

- making sure our regulatory frameworks maintain an acceptable balance between risk and return;
- operating within our regulatory frameworks as efficiently as possible;
- maximising incentives to make the most of our allowed returns;
- careful cash flow management and securing low-cost funding;
- disciplined investment in our networks and non-regulated assets; and
- protecting our reputation.

Using our knowledge and expertise, we engage widely in the energy policy debate to help guide future policy direction. We also work with Ofgem to help them develop the frameworks within which we can meet the changing energy needs of the communities we serve.

**The foundations of our business model**

Our people, being a responsible business, and encouraging innovation are at the heart of our business model and are reflected in our strategy.

Our people

Our business is built on our people. We work hard to make sure that we keep them as safe as possible as well as providing an inclusive culture and encouraging development. See pages 16 and 17 for further details.

Being a responsible business

Doing the right thing is a responsibility we take seriously. Our environmental, financial and social responsibilities are fundamental to the way we work and how we manage our impact on the communities in which we operate. See pages 18 and 19 for our principal operations.

Innovation

Thinking differently and challenging the norms allow our people to develop innovative and more efficient ways of delivering our services and maintaining our networks. See pages 18 and 19 for our principal operations.

# Our vision and strategy

The National Grid vision describes our intentions and aspirations at the highest level. Our strategic objectives set out what we believe we need to achieve to deliver our vision and be recognised as a leader in the development and operation of safe, reliable and resilient energy infrastructure.

| Strategic objective | Description | How we deliver | Relevant KPIs |
|---|---|---|---|
| Deliver operational excellence | Achieve world-class levels of safety, reliability, security and customer service. | Our customers, communities and other stakeholders demand safe, reliable and secure supply of their energy. This is reflected in our regulatory contracts where we are measured and rewarded on the basis of meeting our commitments to customers and other stakeholders.<br><br>Pursuing excellence in all our operational processes will allow us to manage our assets efficiently, deliver network improvements quickly and provide services that meet the changing demands of our customers. | Employee Injury Frequency Rate (IFR)<br><br>Network reliability<br>Customer satisfaction |
| Engage our people | Create an inclusive, high-performance culture by developing all our employees. | It is through the hard work of our employees that we will achieve our vision, respond to the needs of our stakeholders and create a competitive advantage. Encouraging engaged and talented teams that are in step with our strategic objectives is vital to our success.<br><br>Our presence within the communities we serve, the people we work with and our opportunities to grow both individually and as a business are all important to making National Grid a great place to work. | Employee engagement index |
| Stimulate innovation | Promote new ideas to work more efficiently and effectively. | Our commitment to innovation allows us to run our networks more efficiently and effectively and achieve our regulatory incentives. Across our business, we will explore new ways of thinking and working to benefit every aspect of what we do.<br><br>Embedding innovation and new technology into our operations helps us deliver continuous improvements in the quality and cost of our services. | Network reliability |
| Engage externally | Work with external stakeholders to shape UK and EU energy policy. | Policy decisions by Ofgem, Government and others directly affect our business. We engage widely in the energy policy debate, so our position and perspective can influence future policy direction. We also engage with our regulators to help them provide the right mechanisms so we can deliver infrastructure that meets the changing needs of our stakeholders. | Customer satisfaction |
| Embed sustainability | Integrate sustainability into our decision making to create value, preserve natural resources and respect the interests of our communities. | Our long-term sustainability strategy sets our ambition to deliver these aims and to embed a culture of sustainability within our organisation.<br><br>That culture will allow us to make decisions that protect and preserve natural resources and benefit the communities in which we operate. National Grid remains committed to its targets of a 45% reduction in Scope 1 and 2 greenhouse gas emissions by 2020 and 80% by 2050. | Greenhouse gas emissions |
| Drive growth | Grow our core businesses and develop future new business options. | We continue to maximise value from our network, while exploring and evaluating opportunities for growth. Making sure our business maintains the appropriate mix of growth and cash generation is necessary to meet the expectations of our ultimate shareholders.<br><br>We review investment opportunities carefully and will only invest where we can reasonably expect to earn acceptable returns.<br><br>Combining this disciplined approach with operational and procurement efficiencies gives us the best possible opportunity to drive strong returns and meet our commitments to investors. | Regulated asset growth<br><br>Return on equity |

# How our strategy creates value

Our vision and strategic objectives explain what is important to us, so we can meet our commitments and deliver value.

## Customer and community value

**Safety and reliability –** we strive to provide reliable networks safely, which is essential to safeguard our customers, employees and the communities in which we operate.

**Affordability –** we strive to provide services efficiently, which helps to reduce the amount of money customers have to pay for their energy.

**Customer service –** providing essential services that meet the needs of our customers and communities is a crucial part of the value they expect from us.

**Sustainability –** we strive to protect the environment and preserve resources for current and future generations.

**Community engagement –** we listen to the communities we serve and work hard to address concerns about the development of our networks. Our employees volunteer for community-based projects and we support educational initiatives in schools.

## Shareholder value

**Regulatory frameworks –** operating within sound regulatory frameworks provides stability. Making sure these frameworks maintain a balance between risk and return underpins our investment proposition.

**Reputation –** our approach to safety and our reliability record underpin our reputation. These are crucial factors that enable positive participation in regulatory discussions and the pursuit of new business opportunities.

**Efficient operations –** efficient capital and operational expenditure allows us to deliver network services at a lower cost and reduces working capital requirements.

**Maximising incentives –** if we perform well against our incentives, and deliver the outputs our customers and regulatory stakeholders require, we can make the most of our allowed returns.

**Funding and cash flow management –** securing low-cost funding and carefully managing our cash flows help us maintain strong returns for our investors.

**Disciplined investment –** we can increase our revenue and earnings by investing in both regulated and non-regulated assets. This helps us deliver attractive returns for our ultimate shareholders.

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# Delivering our strategy - key performance indicators (KPIs)

The Board uses a range of financial and non-financial metrics, reported periodically, against which we measure National Grid Electricity Transmission performance.

| Strategic element | KPI and definition | Our performance |
|---|---|---|
| **Deliver operational excellence** | **Employee lost time injury frequency rate (IFR)**<br><br>Injuries resulting in employees taking time off work per 100,000 hours worked on a 12 month basis. | **2014/15: 0.11 (target: 0.1)**<br>2013/14: 0.07 (target: 0.1) |
| | **Network reliability**[1]<br><br>Reliability of Electricity Transmission network as a percentage against the target set by Ofgem. | **2014/15: 99.99999% (target 99.9999%)**<br>2013/14: 99.99999% (target 99.9999%) |
| **Engage our people** | **Employee engagement index**[2]<br><br>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. | **2014/15: 75%**<br>2013/14: 71% |
| **Engage externally** | **Customer satisfaction**<br><br>Our score in customer satisfaction surveys. We measure customer satisfaction using RIIO related metrics agreed with Ofgem. | **2014/15: 7.4** (target: 6.9[3])<br>2013/14: 7.4 (target: 6.9[3]) |
| **Embed sustainability** | **Greenhouse gas emissions**<br><br>Percentage reduction in greenhouse gas emissions. | % reduction against 1990 baseline<br>**2014/15: 55% reduction**<br>2013/14: 52% reduction<br>National Grid Target 2014/15 and 2013/14:<br>45% reduction by 2020 and 80% reduction by 2050 |
| **Drive growth** | **Regulated asset growth**<br><br>Maintaining efficient growth in the total Regulated Asset Value (RAV) base. | **2014/15: 4%**<br>2013/14: 8% |
| | **Return on equity (RoE)**<br><br>RoE against the allowed return set by the regulator for the current price control. | **2014/15: 14.0%**<br>2013/14: 12.4% |

[1] Network reliability is also a KPI for our 'Stimulate innovation' strategic objective.
[2] Index represents performance for National Grid.
[3] 6.9 represents our baseline target as set by Ofgem, for reward or penalty under RIIO.

# Financial review

We have delivered another year of strong financial performance.

## Use of adjusted profit measures

In considering the financial performance of our business and segments, we analyse each of our primary financial measures of operating profit and profit before tax into two components.

The first of these components is referred to as an adjusted profit measure. This is the principal measure used by management to assess the performance of the underlying business. Adjusted results exclude exceptional items and remeasurements. These items are reported as the second component of the financial measures. Note 3 to the consolidated financial statements 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 by National Grid 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 | |
|---|---|---|
| | **2015** | 2014 |
| | **£m** | £m |
| Adjusted operating profit | **1,171** | 1,078 |
| Exceptional items | **56** | (60) |
| Total operating profit | **1,227** | 1,018 |

### Reconciliation of adjusted operating profit to adjusted earnings and earnings

| | Years ended 31 March | |
|---|---|---|
| | **2015** | 2014 |
| | **£m** | £m |
| Adjusted operating profit | **1,171** | 1,078 |
| Adjusted net finance costs | **(146)** | (188) |
| Adjusted profit before tax | **1,025** | 890 |
| Adjusted taxation | **(218)** | (211) |
| Adjusted earnings | **807** | 679 |
| Exceptional items after tax | **(3)** | 75 |
| Remeasurements after tax | **(34)** | 9 |
| Earnings | **770** | 763 |

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

Adjusted profit excluding timing differences is discussed below.

| | Years ended 31 March | |
|---|---|---|
| | **2015** | 2014 |
| | **£m** | £m |
| Adjusted operating profit excluding timing differences | **1,260** | 1,138 |
| Timing differences | **(89)** | (60) |
| Adjusted operating profit | **1,171** | 1,078 |
| Exceptional items | **56** | (60) |
| Total operating profit | **1,227** | 1,018 |

## Consolidated income statement commentary

**Revenue**

Revenue for the year ended 31 March 2015 increased by £320 million to £3,713 million. This increase was driven principally by higher allowed transmission owner revenues.

In addition to the above, £43m one-off exceptional other income has been recognised relating to settlement of legal claims.

**Operating costs**

Operating costs for the year ended 31 March 2015 of £2,529 million were £154 million higher than the prior year. This increase in costs was predominantly due to increases in pass-through costs, together with higher depreciation and amortisation as a result of continued investment and increases in our operating costs.

Exceptional items included within operating profit also includes income of £13 million for the year ended 31 March 2015, compared to £60 million of costs in the prior year.

**Net finance costs**

For the year ended 31 March 2015, net finance costs before exceptional items and remeasurements decreased by £42m to £146 million. This was mainly due to effective risk management of the financing portfolio.

Finance cost remeasurements for the year ended 31 March 2015 amounted to a loss of £43 million, primarily arising from derivatives ineligible for hedge accounting. Finance cost exceptional items for the year ended 31 March 2015 totalled £63m following the review and restructure of the debt portfolio. This review resulted in a bond repurchase programme with a notional value of a £169 million.

**Taxation**

The tax charge on profits before exceptional items and remeasurements was £7 million higher than the prior year. This was mainly due to higher profits, countered in part by a reduction in the UK tax rate.

Exceptional tax for the year ended 31 March 2015 included an exceptional deferred tax credit of £3 million arising from a reduction in the UK corporation tax rate from 23% to 21% applicable from 1 April 2014 and a further reduction to 20% from 1 April 2015.

Tax on exceptional items and remeasurements totalled £13 million. This was largely the result of tax on remeasurements relating to the net loss on derivatives financial instruments.

## Consolidated statement of financial position commentary

**Intangible assets**

Intangible assets increased by £14 million to £174 million as at 31 March 2015. This increase primarily relates to software additions of £46 million, partially offset by software amortisation of £20 million.

**Property, plant and equipment**

Property, plant and equipment increased by £624 million to £11,137 million as at 31 March 2015. This was principally due to capital expenditure of £1,026 million relating to the renewal and extension of our regulated networks, offset by £355 million of depreciation in the year. Plant and machinery has been reduced by a £57 million credit resulting from the settlement of legal claims (see note 3 to the Accounts).

**Inventories and trade and other receivables**

Inventories and trade and other receivables have increased by £29 million to £299 million at 31 March 2015.

**Trade and other payables**

Trade and other payables have increased by £103 million to £980 million mainly due to an increase in social security and other taxes.

**Deferred tax liabilities**

The net deferred tax liability increased by £56 million to £791 million. This was primarily due to deferred tax charges on actuarial gains and accelerated tax depreciation.

**Provisions and other non-current liabilities**

Provisions (both current and non-current) and other non-current liabilities decreased by £2 million to £440 million as at 31 March 2015. Total provisions decreased by £20 million in the year. Utilisation of the provisions totalled £17 million, which largely related to the restructuring of UK operations following implementation of RIIO. Other non-current liabilities increased by £18 million principally due to more customer funded work.

**Net debt**

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

**Net pensions obligations**

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

| **Net scheme liability** | **£m** |
|---|---|
| As at 1 April 2014 | (510) |
| Current service cost | (23) |
| Net interest cost | (19) |
| Curtailments and settlements – other | (10) |
| *Actuarial gains/(losses)* | |
| -on plan assets | 432 |
| -on plan liabilities | (371) |
| Employer contributions | 91 |
| **As at 31 March 2015** | (410) |

The principal movements in net obligations during the year include net actuarial gains of £61 million and employer contributions of £91 million. Net actuarial gains include actuarial losses on plan liabilities of £371 million. The overall movement in the deficit was a reduction of £100 million.

Further information on our pensions benefit obligations can be found in notes 17 and 23 to the consolidated financial statements.

**Off balance sheet items**

There were no significant off balance sheet items other than the contractual obligations shown in note 24 (b) to the consolidated financial statements, and the commitments and contingencies discussed in note 21.

## Cash flow statement commentary

Cash inflows and outflows are presented to allow users to understand how they relate to the day-to-day operations of the business (operating activities); the money that has been spent or earned on assets in the year, including acquisitions of physical assets or 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**

| | **2015 £m** | 2014 £m |
|---|---|---|
| Cash generated from operations | **1,648** | 1,387 |
| Net capital expenditure | **(956)** | (1,194) |
| Business net cash flow | **692** | 193 |
| Net interest paid | **(230)** | (202) |
| Tax paid | **(143)** | (141) |
| Dividends paid | **(655)** | (300) |
| Other | **(173)** | (46) |
| **Increase in net debt** | **(509)** | (496) |
| Opening net debt | **(6,415)** | (5,919) |
| **Closing net debt** | **(6,924)** | (6,415) |

Cash flows from our operations are largely stable when viewed over the longer term. Our electricity transmission operations are subject to a multi-year regulatory agreement. We have largely stable intra-year cash flows. For the year ended 31 March 2015, cash flow from operations increased by £261 million to £1,648 million.

Adjusted operating profit before depreciation and amortisation was £127 million higher year on year. Working capital changes improved by £15 million from the prior year because of the milder weather than expected which drives lower volumes than forecasted. Cash inflows relating to exceptional items were £160 million higher in comparison to the prior year due to reduction in reorganisation costs and the inflow of receipts relating to a legal settlement (see note 3 to the consolidated financial statements).

**Net capital expenditure**

Net capital expenditure in the year of £956 million was £238 million lower than the prior year.

**Dividends paid**

Dividends paid in the year ended 31 March 2015 amounted to £655 million.

**Other**

Other principally relates to non-cash movements due to changes in fair values of financial assets and liabilities, interest accretions, accruals and foreign exchange movements arising on net debt held in currencies other than sterling.

## Earnings

**Timing and Regulated Revenue Adjustments**

Our allowed revenues are set in accordance with our regulatory price control. We calculate the tariffs we charge our customers based on the estimated volume of energy 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.

The amounts calculated as timing differences are estimates and subject to change until the variables that determine allowed revenue are finalised. Our operating profit for the year includes a total estimated in-year under-recovery of £89 million (2013/14: £60 million under-recovery). Our closing balance at 31 March 2015 was £164 million under-recovery (2014: under-recovery of £75 million). All other things being equal, the majority of that balance would normally be recoverable from customers starting in the year ending 31 March 2016.

In addition to the timing adjustments described to the left, 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.

For our business as a whole, regulated revenue adjustments totalled to an over-recovery of £130 million in the year. This is based on our estimates of work carried out in line with allowances, in expectation of future allowances, or work avoided altogether, either as a result of National Grid finding innovative solutions or the need being permanently removed.

# Our people

If we are to achieve our strategic goals, we need to make sure our employees have the right skills and capabilities.

## Building skills and expertise

During 2014/15 we have worked on boosting the capabilities of our employees in the areas of performance excellence, stakeholder engagement, customer focus and contract management. We see these capabilities as being crucial in helping us improve our performance and meet regulatory and customer expectations.

More than 900 employees have attended National Grid's Performance Excellence programmes; more than 650 employees have attended its stakeholder engagement and customer focus programmes; and around 250 employees have attended its contract management programmes.

Our Executive team and senior leaders are participating in a programme to develop performance leadership skills. To prepare for our future engineering skills needs National Grid is building a T-pylon development facility at our Eakring learning centre.

We remain committed to investing in our people, providing the training and other support necessary for them to build, maintain and operate our network safely and reliably, and this year we provided more than one million learner hours of training across the National Grid business.

## Safeguarding the future

There is a significant skills challenge facing the engineering profession. Research by EngineeringUK has highlighted a need for 1.82 million engineers, technicians and crafts people over the period 2012-2022. Around 60% of all new jobs in this period will need science, technology, engineering and maths (STEM) qualifications, yet not enough school children succeed in these areas.

We are helping schools, parents and children see engineering as a modern, dynamic, desirable career with a great future. Our employees act as education ambassadors who volunteer their time for a range of activities in the classroom and at science and engineering fairs, most notably on STEM enrichment, careers education and work experience programmes.

Our careers education programmes include Careers Lab, an initiative we developed that was taken up by the charity Business in the Community in November 2014. It links working professionals from a range of sectors with schools to bring the world of work to life for secondary school children. A further initiative is the 'Engineer Your Future' exhibition at London's Science Museum, which opened in December 2014 and explores engineering challenges through interactive games and digital experiences.

During 2014/15 National Grid have expanded its residential work experience programme (balanced 50/50 between girls and boys) to include a non-residential programme for students aged 16-19 who are in sixth form or college education and do not have an existing relationship with an employer.

During 2014/15 National Grid invested nearly £900,000 in education outreach, bringing benefits to 70 schools and around 9,000 students who receive at least one-hour of STEM/careers experience with our education ambassadors. National Grid expects this to grow considerably through Careers Lab.

National Grid offers summer internships and also 12 month industrial placements to undergraduates in their penultimate year. These programmes offer students the opportunity to experience the culture, working and ethical practices of National Grid before they make the all-important decision to join the organisation as graduates.

## Volunteering

Our employees continue to support our local communities, sharing their time and expertise on a range of skills-based volunteering and fundraising activities.

National Grid raised over £500,000 for good causes and provided over 9,000 hours of support to community projects in the UK. Our support of City Year now includes a new mentoring programme in Birmingham and we launched 'Good Leaders', a programme that shares our leadership expertise with the charity sector.

## Health and wellbeing

Among our programmes for 2014/15 National Grid have worked to address the stigma and discrimination associated with mental health. We signed the UK Government-led 'Time to Change' pledge and have trained a further 92 employees in mental health first aid. National Grid also helped more than 4,000 employees and service providers' staff understand their 'heart age' and run a weight-loss campaign that raised £4,000 for Macmillan Cancer Support.

## Promoting an inclusive and diverse workforce

We aim to develop and operate our business with an inclusive and diverse culture, with equal opportunity to all in recruitment, career development, training and reward. This applies to all employees regardless of race, gender identity, nationality, age, disability, sexual orientation, religion and background. Our policies support the attraction and retention of the best people, improve effectiveness, deliver superior performance and enhance our success.

National Grid was recognised as a Times Top 50 Employer for Women for 2015 and reached the Gold level in our benchmarking with both Race for Opportunity and Opportunity Now during 2014. Both these campaigns also recognised National Grid as a Top 10 private sector employer. National Grid's Employee Resource Groups (ERGs) continue to support its business goals and participate in events that encourage students to consider careers needing STEM qualifications.

The table below shows the breakdown by gender at different levels of the organisation. We have included information relating to directors, as this is required by the Companies Act 2006 (Strategic Report and Directors' Reports) Regulations 2013. We define 'senior management' as those managers who are at the same level, or one level below the Executive Committee.

| | Financial year ending 31 March 2015 | | | | |
|---|---|---|---|---|---|
| | Male | Female | Total | % Male | % Female |
| Our Board | 8 | 1 | 9 | 89 | 11 |
| Senior Management | 36 | 7 | 43 | 84 | 16 |
| Whole Company | 2,642 | 628 | 3,270 | 81 | 19 |

## Human rights

Respect for human rights is incorporated into our employment practices and our values. See pages 16 and 17 for more information.

## 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 measures and reports its greenhouse gas emissions in accordance with the World resources institute (WRI)/ World business council for sustainable development (WBCSD) Greenhouse Gas Protocol: Corporate Accounting and Reporting Standard (Revised Edition) for all six Kyoto gases using the operational control approach for emissions accounting.

Those Scope 1 and 2 emissions are independently assured against the international standard ISO 14064-3 Greenhouse Gas assurance protocol. A copy of this statement of assurance is available on the National Grid website.

# Principal Operations

## Overview

Our business delivered a strong financial performance in the second year of RIIO. We aim to create value for our stakeholders by focusing on performance and making sure our processes are as efficient as they can be.

We have also established a new organisational structure to give stakeholders a clearer picture of how our activities are organised and delivered.

We have responded to concerns about the cost of energy and the security of the UK's energy. In evidence to Parliamentary inquiries we have explained our role, the services we provide and what those services cost. We have also been working with stakeholders in Europe to plan for the future impact of European Union energy policy on our business.

## Principal risks

We identify, monitor and manage risks at various levels within our Company. The key risks our business faces are organised into a regional risk profile which is regularly reviewed by the UK senior leadership of National Grid. The main risk themes currently featured in this profile are:

- the risk of changes to the complex political and regulatory agenda for UK and European policy development and their potential implications for our business;
- challenges associated with making sure the data required to deliver business processes and regulatory requirements is complete, accurate and consistent;
- the impact of changes in our business structure and processes on our ability to continue to perform under RIIO; and
- continued management of safety, security and network resilience.

## What we do

We own the electricity transmission system in England and Wales. Our networks comprise approximately 7,200 kilometres (4,470 miles) of overhead line, 1,500 kilometres (932 miles) of underground cable and 336 substations.

We are also the national electricity transmission system operator, responsible for both the England and Wales transmission system, and the two high voltage transmission networks in Scotland, which we do not own.

As System Operator (SO) for England and Wales, we coordinate and direct electricity flows onto and over the transmission system, balancing generation supply and user demand. Where necessary, we pay sources of supply and demand to increase or decrease their generation or usage.

We have the same role for the two high voltage electricity transmission networks in Scotland and we are SO for the offshore electricity transmission regime. We do not own these networks.

Our charges for SO services in the UK are subject to a price control approved by Ofgem. System users pay us for connection, for using the system and balancing services.

As electricity transmission SO, our price control includes incentives to minimise the costs and associated risks of balancing the system through buying and selling energy, as well as procuring balancing services from industry participants.

## Market Context

Although demand for electricity is generally increasing around the world, in the UK it is expected to remain broadly flat over the next five to ten years. Impacts of embedded solar and wind generation in the Distribution networks are however causing demand variations on the transmission network and challenges to system operation.

Changes in the sources and characteristics of generation connecting to our network, such as wind and nuclear generation, mean we need to respond by developing the way we balance and operate our network to accommodate these sources.

Over the last two years some generators have delayed their connection dates to the network and this means our future investment profile for electricity transmission is flatter than in previous years. But we are ready to respond to connection dates when we need to. We will continue to renew our network to deliver the network reliability our customers require as efficiently as possible.

## What we've achieved during 2014/15

The full tunnel network on our London Power Tunnels project has been completed, and the remaining works programme is forecast to complete ahead of schedule and under budget.

We made progress on substation and cable construction work for several new Network Rail connections, as well as Crossrail connections in London. These connections are required to support the national railway electrification programme from 2015 to 2017.

We achieved a significant engineering milestone, installing the first ever 'series compensation' device on the UK network. This device, which adds capacity to a transmission circuit, will increase power flows from Scotland. With both National Grid and Scottish Power series compensation in service, the Scotland- England boundary capacity will increase by 1GW.

We have continued to develop the innovative T-pylon and are considering where it could be offered alongside other connection options when developing new transmission circuits. The first T-pylon has been installed at our Eakring training facility.

Our Visual Impact Provision (VIP) project gathered pace. Our policy to make use of the £500 million allowance under RIIO to mitigate the visual impact of our overhead lines in National Parks and Areas of Outstanding Natural Beauty was agreed with Ofgem. A stakeholder advisory group, including representatives of organisations with a national focus on our natural heritage, is helping us choose which transmission lines should be prioritised and how the fund should be allocate

We agreed an RPI-linked, bank loan facility of £1.5 billion with the European Investment Bank (EIB). This is the largest ever single loan by the EIB and is now available to fund capital investment in National Grid Electricity Transmission.

We also deployed new tools and systems to our field workforce, winning the Mobile Innovation category at the SAP UK Quality Awards.

**System Operator (SO) progress**

The UK faces tightening capacity margins between supply and demand for the next three years. Helping the market to make the right decisions to maintain security of supply has been an important theme in National Grid's role as SO during 2014/15.

Following a number of generation plant outages over the winter, the two new balancing services developed to provide additional reserves were tendered as a precaution. Although these additional reserves were not used this year, they have also been tendered to procure additional capacity for winter 2015/16 when margins are predicted to tighten further.

We have continued to work with stakeholders to develop and implement EMR. We completed pre-qualification and auctions for the Capacity Market and the Contract for Difference (CfD) feed-in tariff regime. The capacity market auction this year procured additional capacity ready for the first year of delivery in 2018/19. Contracts were signed with 25 applicants following the first auction for CfD.

**Principal movements (2013/14 – 2014/15)**

| | Adjusted operating profit £m |
|---|---|
| 2013/14 adjusted operating profit | 1,078 |
| Timing[1] | (29) |
| Net regulated income[2] | 187 |
| Regulated controllable operating costs[3] | (27) |
| Depreciation and amortisation[4] | (33) |
| Post retirement costs | (4) |
| Other | (1) |
| **2014/15 adjusted operating profit** | **1,171** |

1 In year under-recovery of £89 million compared with an under-recovery in the prior year of £60 million. The estimated closing under-recovered value at 31 March 2015 is £164 million.
2 Revenues increased driven by increase in regulatory allowances.
3 Increased costs driven by inflation.
4 Depreciation and amortisation is higher as a result of continued investment.

## Priorities for the year ahead

- **Safety:** Make sure our suppliers and employees manage their safety performance when working near our transmission assets. This includes seeking evidence that they are using effective safety management systems.
- **Maintenance:** Establish a programme to change the way we plan and deliver all work on our assets by balancing risk, performance and delivery costs.
- **Hinckley Point C connection:** Continue to progress the regulatory submissions needed for the Hinckley Point C connection project to secure the funding for delivery.
- **Visual Impact Provision:** Through our VIP project we will identify the final locations where the visual impact of our networks will be reduced.
- **Data and technology:** Continue to improve how we define and capture the network data that helps us make better decisions on our assets and respond more quickly to customer demand for new connections.
- **Winter margins:** Operating the network through a period of tightening winter margins and developing our balancing products to help the market maintain security of supply.

# Internal control and risk management

National Grid Electricity Transmission is exposed to a variety of uncertainties that could have a material adverse effect on the Company's financial condition; our operational results; and our reputation.

The National Grid Electricity Transmission Board is committed to protecting and enhancing our reputation and assets, while safeguarding the interests of our ultimate shareholders. It has responsibility for the Company's system of risk management and internal control. National Grid Electricity Transmission is also responsible for providing oversight of the risk management and internal control activities within the Company.

## Risk management approach

National Grid's group-wide corporate risk management process provides a framework through which we can consistently identify, assess, prioritise, manage, monitor and report risks. This process is designed to support delivery of our vision and strategic objectives as described on pages 9 and 10.

The process involves a continuous cycle of bottom-up review and reporting and top-down review and feedback.

All of the business functions of National Grid Electricity Transmission participate in a bottom-up risk management process. They identify the main risks to achieving their objectives and the actions being taken to manage and monitor them. They assess each risk by considering the potential 'worst case credible' financial and reputational impacts and how likely the risk is to materialise. Risks identified are collated in risk registers and are reported at functional and regional levels within the group. The risk registers also describe the adequacy of our existing risk controls.

An important feature of the risk management process is that each business function owns and is responsible for managing its particular risks. A central risk management team acts as an advisory function and also provides an independent challenge and review. This team partners with the business functions through nominated risk liaisons and collaborates with assurance teams and specialists, such as internal audit and compliance management, to sense check risk information.

Regional senior management regularly review and debate the outputs of the bottom-up process and agree the prioritisation of the risks. The main risks for National Grid Electricity Transmission are highlighted in regional risk profiles and reported to the Chief Executive through quarterly performance reports.

The main strategic uncertainties or 'principal risks' for National Grid Electricity Transmission are developed through top-down discussions with the Executive leadership team. These risks are reported and debated with the National Grid Executive Committee and National Grid Audit Committee every six months. The National Grid Electricity Transmission Audit Committee monitors the effectiveness of the risk management process during the year through the triannual reports it receives.

The National Grid Board participates in an annual interactive risk workshop to make sure that the principal risks remain closely aligned to the strategic aims and that no important risks (or combination of risks) are being overlooked. In addition, the National Grid Board considers emerging risks (uncertainties that are still developing and sit outside the principal risks profile) together with the strategy team's annual long-term update. The outcomes from each level of the risk review process are fed back to the relevant teams and incorporated as appropriate into the next cycle of the ongoing process.

## Internal audit

The Company does not have a separate internal audit function. This function is provided by National Grid's Corporate Audit function. The National Grid Corporate Audit function provides independent, objective, assurance to the National Grid Electricity Transmission Audit Committee, the Safety, Environment and Health Committee (SEH) and the Executive Committee, as to whether the organisation's existing control and governance frameworks are operating effectively in order to meet National Grid's strategic objectives.

Audit work is delivered by a combination of suitably qualified employee, who typically have either a finance or operational business background and external co-source partners, where specific specialist skills are required.

The annual audit plan is principally risk-based but includes cyclical reviews. Inputs to the plan include risk registers, corporate priorities, external research of emerging risks and trends and discussions with senior management. A number of focus areas are identified, such as financial, regulatory and asset management processes. Appropriate coverage is provided across each of these areas. A tool that captures all auditable areas, prior coverage and inherent process risk is also used to inform of audits that should be undertaken on a cyclical basis.

The plan is reviewed by the Audit Committee in March each year, with focus given to not only the areas which are being covered but also those that are not, so we can make sure that the plan aligns with the Committee's view of risk.

Corporate Audit provides a twice-yearly report to the Audit Committee. The report summarises common control themes arising and progress with implementing management action plans, and also presents information on specific audits as appropriate. Where specific control issues are identified, senior leaders may be invited to attend the Audit Committee to provide a commentary around the actions they are taking to improve the control environment within their area of responsibility.

## Auditors' independence and objectivity

As highlighted in National Grid's Annual Report and Accounts for 2014/15 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.

Auditor independence and objectivity is safeguarded by a number of control measures, including limiting the nature and value of non-audit services performed by the external auditors, ensuring that employees of the external auditors who have worked on the audit in the past two years are not appointed to senior financial positions within National Grid, and the rotation of the lead engagement partner at least every five years.
The current lead engagement partner has held the position for four years.

## Our principal risks

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, the 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. An overview of the key inherent risks we face is provided on pages 173 to 176 within the National Grid Annual Report and Accounts. Examples include:

- aspects of the work we do could potentially harm employees, contractors, members of the public or the environment;
- we may suffer a major network failure or interruption, or may not be able to carry out critical operations due to the failure of infrastructure, data or technology or a lack of supply;
- changes in law or regulation or decisions by governmental bodies or regulators could materially adversely affect us;
- current and future business performance may not meet our expectations or those of our regulators and stakeholders;
- changes in interest rates could materially impact earnings or our financial condition;
- our results of operations could be affected by inflation or deflation;
- we may be required to make significant contributions to fund pension and other post-retirement benefits;
- an inability to access capital markets at commercially acceptable interest rates could affect how we maintain and grow our businesses; and
- customers and counterparties may not perform their obligations

Our corporate risk profile contains the principal risks that the National Grid Board considers to be the main ones currently faced by the Company as we endeavour to achieve our strategic objectives. An overview of the key risks is provided on page 22, together with examples of the relevant controls and mitigating actions we are taking.

## Principal risks

| Strategic objective | Risk description | Example of mitigations |
|---|---|---|
| Drive growth | Failure to identify and execute the right opportunities to deliver our growth strategy.<br><br>Failure to sufficiently grow our core business and have viable options for new business over the longer term would negatively affect National Grid's credibility and jeopardise the achievement of intended financial returns.<br><br>Our ability to achieve our ambition for growth is subject to a wide range of external uncertainties, including the availability of potential investment targets and attractive financing and the impact of competition for onshore transmission; and internal uncertainties, such as the performance of our operating businesses and our business planning model assumptions. | We regularly monitor and analyse market conditions, competitors and their potential strategies, the advancement and proliferation of new energy technologies. We are also looking to access new sources of finance and capabilities through partnering.<br><br>We have internal processes for reviewing and approving investments in new businesses, disposals of existing ones and organic growth investment opportunities. These processes are reviewed regularly to make sure our approach supports our short and long-term strategies. We undertake due diligence exercises on investment or partnering opportunities and carry out post-investment reviews to make sure we learn lessons for the future. |
| Engage externally | Inability to influence future energy policy.<br><br>Policy decisions by Ofgem, Government and others directly affect our business. We must engage widely in the energy policy debate, making sure our position and perspective help to shape future policy direction. | We are continuing to work closely with DECC and Ofgem on Electricity Market Reform (EMR) plans. We successfully implemented the first Capacity Market Auction and Contracts for Difference Allocation process and are working with the Regulator to finalise the enduring EMR Business Plan to ensure we continue to deliver value under RIIO. We continue to maintain strong relationships with Government, engage in consultations, and develop comprehensive stakeholder communications plans. The Board is also continuing to monitor the increasing public debate around the cost, availability, security and sustainability of energy supplies. |
| Engage our people | Inability to secure the business capacity, appropriate leadership capability and employee engagement levels required to deliver our vision and strategy.<br><br>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 on our strategic objectives is vital to our success. We must attract, integrate and retain the talent we need at all levels of the business. | We have identified the core capabilities that align with our strategic ambition.<br><br>We have filled key leadership roles with a mix of internal and external hires.<br><br>We are involved in a number of initiatives to help secure the future engineering talent required.<br><br>We continue to develop our succession plans for key roles, including leadership.<br><br>We continue to actively promote inclusion and diversity.<br><br>We monitor employee engagement and formally solicit employee opinions via a Group-wide employee survey annually. |

| Strategic objective | Risk description | Example of mitigations |
|---|---|---|
| Deliver operational excellence | Failure to achieve levels of financial performance required to meet regulatory requirements.<br><br>The Company operates under a complex regulatory regime and we must maintain the performance levels required. Failure to achieve the agreed returns could damage our reputation and threaten future growth opportunities and regulatory arrangements. | The operating model implemented in 2013 to support our performance under RIIO is now established and we continue to roll out our Performance Excellence framework across the business.<br><br>We monitor network reliability and customer satisfaction as KPIs, as described on page 11. |
| | Failure to deliver appropriate information systems and data integrity.<br><br>The Company is increasingly reliant on technology to support and maintain our business-critical processes. We must be able to rely on the performance of these systems and the underlying data to meet our obligations under our regulatory agreements, and comply with the agreement with bond holders and other providers of finance. | We are implementing a global information management framework focusing on data integrity and security.<br><br>We completed a data assurance programme last year and actions to improve our data quality and integrity processes based on the results are being managed by the business functions. |
| | We experience a catastrophic/major cyber security breach.<br><br>Due to the nature of our business we recognise that our critical national infrastructure (CNI) systems may be a potential target for cyber threats. We must protect our business assets and infrastructure and be prepared for any malicious attack. | We use industry best practices as part of our cyber security policies, processes and technologies.<br><br>We continually invest in cyber strategies that are commensurate with the changing nature of the security landscape. This includes collaborative working with DECC and the Centre for Protection of National Infrastructure (CPNI) on key cyber risks and development of an enhanced CNI security strategy. |
| | Failure to prevent a significant process safety event.<br><br>Safety is paramount. Some of the assets owned and operated by National Grid are inherently hazardous and process safety incidents, whilst extremely unlikely, can occur.<br><br>Our objective is to be an industry leader in managing the process safety risks from our assets to protect our employees, contractors and the communities in which we operate. We operate in compliance with local legislation and regulation. In addition we identify and adopt good practices for safety management. | We continue to commit significant resources and financial investment to maintain the integrity of our assets and we strive to continuously improve our key process safety controls.<br><br>We continue to implement the National Grid Group-wide process safety management system to ensure a robust and consistent framework of risk management exists across our higher hazard asset portfolio.<br><br>We are developing a suite of risk models to assess the risk of specific asset types and support targeted investment to reduce risk.<br><br>We monitor a mix of leading and lagging process safety indicators and test the effectiveness of our controls with periodic audits. |

# Our internal control process

We have a number of processes to support our internal control environment. These processes are managed by dedicated specialist teams. Oversight of these activities is provided through regular review and reporting to the appropriate Board committees as outlined in the Corporate Governance section on pages 25 to 27.

## Reviewing the effectiveness of our internal control

Each year the National Grid Board reviews the effectiveness of our internal control process, including financial reporting, to make sure it remains robust. The latest review covered the financial year to 31 March 2015 and the period to the approval of this Annual Report and Accounts. It included:

- the Certificate of Assurance for noting following approval by the Audit Committee to provide overall assurance around the effectiveness of National Grid's risk management and internal controls systems;
- where appropriate, assurance from our committees, with particular reference to the reports received from the Audit, and Safety, Environment and Health Committees on reviews undertaken at their meetings; and
- assurances about the certifications required under Sarbanes-Oxley as a result of National Grid's US reporting obligations.

The National Grid risk management and internal control processes comply with the Turnbull guidance on internal control and the requirements of the UK Corporate Governance Code.

National Grid has reviewed the new UK Corporate Governance Code, published in September 2014 against its risk management and internal control systems and processes. Refinements in these systems and processes will be implemented, as appropriate, over the coming year.

## Internal control over financial reporting

National Grid has specific internal mechanisms to govern the financial reporting process and the preparation of the Annual Report and Accounts. The financial controls guidance sets out the fundamentals of internal control over financial reporting, which are applied across the whole Group, including National Grid Electricity Transmission.

The financial processes within National Grid include a range of system, transactional and management oversight controls. In addition, National Grid Electricity Transmission prepares 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 Chief Executive and Finance Director of National Grid which consider historical results and expected future performance and involve senior management from both operational and financial areas of the business.

The Finance Director presents a consolidated financial report at each National Grid Electricity Transmission Board meeting.

The Strategic Report was approved by the Board of Directors on 1 July 2015 and signed on its behalf by:

**Andy Agg**
Director

# Corporate Governance

## Corporate Governance Statement

National Grid Electricity Transmission aims to achieve high standards of leadership and governance. At the National Grid level, its Board considers that it complied in full with the provisions of the UK Corporate Governance Code 2012 (the Code) during the year being reported on. National Grid Electricity Transmission is not required to comply with the principles of the Code, however the Board is mindful of the Code and the Corporate Governance statement sets out the principal areas of 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 responsible for governance, and oversees its compliance with all relevant laws and regulations, including compliance with its Electricity Transmission Licence. The operational and financial management of the Company's businesses is undertaken by committees, in compliance with business separation obligations.

### Board composition

The Board has undergone significant change during the last financial year. In accordance with the relevant Licence conditions, the Company appointed two non-executive directors (NEDs), (also termed sufficiently independent directors (SIDs)), to the Board of the Company. Dr Catherine Bell and Dr Clive Elphick were appointed with effect from 1 April 2014. Additionally a review of the Board membership was undertaken, and in consultation with its shareholder, the Board appointed three new directors in October 2014. These directors were appointed from the senior management within the business. At this time Paul Whittaker stepped down from the Board.

Looking ahead to the next financial year the Company will see a change in Chairmanship of the Board. As previously announced in the National Grid plc Annual Report and Accounts for 2013/2014, Nick Winser will be leaving the Company during July 2015. Following Nick's departure John Pettigrew will assume the role of non-independent Chairman of the Board. The Board of the Company will make further appointments 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

Following Catherine and Clive's appointment to the Board, a comprehensive induction programme was arranged, which had been tailored to Catherine and Clive's background and experience.

To strengthen the Board's knowledge and understanding of the Company, Board meetings regularly include updates and presentations on specific aspects of the business.

Board members attend meetings regularly in order to ensure they are kept up to date with the business and accordingly can contribute to meetings. The schedule of board meeting dates is set and communicated a minimum of one year in advance. The agenda for each meeting is set by the Chairman in line with the Board's responsibilities and follows a management reporting cycle which links to that of National Grid plc. Directors are sent papers for meetings of the Board in accordance with guidelines concerning the content, timeliness and preferred presentation of papers to ensure Directors are briefed appropriately.

### Board performance evaluation

A board evaluation of the current governance structure affecting the Company has been scheduled to take place during the first quarter of the next financial year. The evaluation process will be undertaken by an external provider who specialises in operational subsidiary board evaluations within a regulatory framework. The timing of the review will enable the Board to reflect on the changes that have been implemented during 2014/2015, allow the sufficiently independent directors to reflect on their role a year after their appointment, and allow the change in Chairmanship to build and develop the Board for the future.

### Board membership and attendance

Six Board meetings were scheduled during the last financial year, although the Board may meet more frequently as required. Board membership and attendance at meetings are 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 2015.

| | **Attendance** |
|---|---|
| Nick Winser (chair) | 6 of 6 |
| John Pettigrew | 6 of 6 |
| Andy Agg | 6 of 6 |
| Malcolm Cooper | 6 of 6 |
| Paul Whittaker (*Resigned 30 September 2014)* | 3 of 3 |
| Mark Ripley *(Appointed 1 October 2014)* | 3 of 3 |
| Mike Calviou *(Appointed 1 October 2014)* | 3 of 3 |
| David Wright *(Appointed 1 October 2014)* | 3 of 3 |
| Catherine Bell (SID) *(Appointed 1 April 2014)* | 6 of 6 |
| Clive Elphick (SID) *(Appointed 1 April 2014)* | 6 of 6 |

# Committees

The Board has established a number of committees and sub-committees which assist it in its activities. In November 2014 the Board established an Audit Committee comprising of the sufficiently independent directors, the Chairman of the Board and a further Board director. Other committees include the Electricity Transmission Executive Committee, the Compliance Committee, the System Operator Executive Committee and the Finance Committee. The Company does not have a Nominations or Remuneration Committee as these functions are provided by National Grid and their roles relevant to the Company are explained below. See the Annual Report and Accounts of National Grid for further information about these committees.

## 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 42c of the Electricity Act 1989, the Company has provided to Ofgem details of the linkages between Directors' remuneration and service standards.

## Electricity Transmission Executive Committee

During the year the Transmission Executive Committee was split into the Gas Transmission Executive Committee (GTEC) and the Electricity Transmission Executive Committee (ETEC). The purpose of ETEC is to direct the affairs of the Electricity Transmission Owner business on behalf of its Board, 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 shall extend to approving the Electricity 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 shall carry assurance responsibilities for the Electricity Transmission 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 shall receive summary reports from Process Performance Meetings, Regulatory Commercial Committees and Business Partner Functions.

ETEC acts within National Grid's overall corporate governance framework and delegated authorities and is responsible for the operational and financial management of the Electricity Transmission business. Directors of the Company, senior managers of the Electricity Transmission business and certain other senior managers, and their attendance at meetings during 2014/15 is set out below. Attendance is expressed as number of meetings attended out of number eligible to attend, and includes attendance by a nominated deputy.

| | | Attendance |
|---|---|---|
| Ian Galloway (Chair) | Director Capital Delivery | 3 of 3 |
| David Wright | Director of Electricity Transmission Asset Management | 3 of 3 |
| Mark Ripley | Director of UK Regulation | 1 of 3 |
| Cordi O'Hara | Director of UK Market Operation | 3 of 3 |
| Chris Bennett | Head of RIIO Delivery | 2 of 3 |
| Ian Cartwright | Delegate – Director Capital Delivery | 3 of 3 |
| Mark Brackley | Head of Electricity Network Development Process | 3 of 3 |
| Jenny Dillon | Electricity Transmission Lead Finance Business Partner | 2 of 3 |
| Chris Train | Group Director Safety Sustainability and Resilience | 1 of 3 |
| David Salisbury | Head of Data and Technology | 3 of 3 |
| Helen Barratt[1] | Director of UK Shared Services | 2 of 2 |
| Duncan Brown[1] | Director of UK Shared Services | 1 of 1 |
| Bilal Shaykh | Head of UK Procurement | 2 of 3 |
| Joss Clarke | Head of UK Employee Communications | 3 of 3 |
| Tina Sands | Head of IS UK | 1 of 3 |
| Chris Mead | HR Business Partner | 3 of 3 |
| Hector Cruz | Head of UK Audit | 3 of 3 |
| Alison Kay[2] | UK General Counsel | 0 of 2 |
| Rachael Davidson[2] | UK General Counsel | 1 of 1 |

[1] *Duncan Brown replaced Helen Barratt in February 2015.*
[2] *Rachael Davidson replaced Alison Kay in February 2015.*

The Electricity Transmission Executive Committee has a number of sub-committees dealing with matters such as investment, 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. Three meetings took place prior to a change in committee membership. Following this six meetings have taken place. Membership of this committee comprises Directors of the Company, senior managers of the Transmission business and certain other senior managers, and their attendance at meetings during 2014/15 is set out below. Attendance is expressed as number of meetings attended out of number eligible to attend, and includes attendance by a nominated deputy.

The SOEC has a number of sub-committees dealing with matters such as SO specific investments and SO incentive risk management. In addition to these matters, a committee accountable for commercial and regulatory framework matter is jointly accountable to SOEC and ETEC.

| | | **Attendance** |
|---|---|---|
| Mike Calviou (Chair) | Director of UK Transmission Network Services | 6 of 6 |
| Cordi O'Hara | Director of UK Market Operation | 5 of 6 |
| Nicola Pitts | Head of Process – Operate the System | 6 of 6 |
| Darren Pettifer | Lead Finance Business Partner | 5 of 6 |
| Mark Ripley | Director UK Regulation | 6 of 6 |
| Mark Tomlinson | Legal Business Partner | 1 of 6 |
| George Mayhew | Corporate Affairs Director | 2 of 6 |
| Janine Freeman | Head of EU Public Affairs | 5 of 6 |
| Tina Sands | Head of IS UK | 4 of 6 |
| Huma Ali | HR Business Partner | 3 of 3 |

## Compliance Committee

The Board has established a Compliance Committee, comprising both executive and sufficiently independent directors, to oversee the business separation between the Company and National Grid Offshore Limited, in accordance with business separation licence obligations.

## 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.

## Audit Committee

In November 2014 the Board established an Audit Committee whose role is to keep under review the Company's financial reporting and internal controls and their effectiveness, together with reviewing the Company's risk register and risk reports presented by management. It also reviews the external audit plan and reviews the external auditors' findings.
Membership of this committee is comprised of four Board directors: the Chairman, a director and two sufficiently independent directors. Two meetings took place during the last financial year. Committee membership and attendance at meetings are 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 2015.

| | Attendance |
|---|---|
| Nick Winser (chair) | 2 of 2 |
| Malcolm Cooper | 2 of 2 |
| Catherine Bell | 2 of 2 |
| Clive Elphick | 2 of 2 |

## Group holding company

During the year, John Pettigrew was also an Executive Director of National Grid. Through participation at the Boards of both companies, the Board of National Grid Electricity Transmission is well placed to identify and facilitate understanding of the views of its shareholder.

# Business separation

Special Condition 2D of our electricity transmission licence requires that the Company maintains managerial and operational systems such that:

- the relevant offshore transmission interest (National Grid Offshore Limited) does not gain unfair advantage by reason of the way the Company conducts its electricity transmission business, as required by Standard Condition C1;
- cross-subsidy between the electricity transmission business and relevant offshore transmission interest is avoided, as required by Special Condition B5; and
- the obligations under Standard Condition B6 around restriction on activity and financial ring-fencing are complied with.

Our policy on business separation is set out in the Company's Compliance Statement.

We have taken the following specific actions to comply with the requirements of Special Condition 2D and report annually to Ofgem on compliance:

- established separate management for the electricity transmission and relevant offshore transmission business;
- appointed a Compliance Committee for the electricity transmission business which reports directly to the Board of the Company;
- appointed a Business Separation Compliance Officer, who reports to the Compliance Committee twice yearly; and
- appointed a Responsible Director for System Operation who assumes day to day responsibility for maintaining appropriate managerial and operational independence of the licensee.

Special Condition 2B of our electricity transmission licence applies where National Grid Electricity Transmission has received an application in relation to a possible connection in an area outside its transmission area. The condition requires National Grid Electricity Transmission to treat connection applications confidentially and where an alternative application is received for connection in England and Wales, it requires that each application is dealt with by separate and independent teams.

Our policy in respect of Special Condition 2B is set out in the Company's Compliance Statement.

We have taken the following specific actions to comply with the requirements of Special Condition 2B:

- established a process where separate teams would be used in the event of an alternate application being received; and
- appointed a Compliance Officer, who reports to the Directors of the licensee through the National Grid Electricity Transmission Board.

# Directors' Report

The Directors present their report and the audited consolidated financial statements of the Company for the year ended 31 March 2015. 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 | |
| Catherine Bell (SID*) | Appointed 1 April 2014 |
| Mike Calviou | Appointed 1 October 2014 |
| Malcolm Cooper | |
| Clive Elphick (SID*) | Appointed 1 April 2014 |
| John Pettigrew | |
| Mark Ripley | Appointed 1 October 2014 |
| Paul Whittaker | Resigned 30 September 2014 |
| Nick Winser | |
| David Wright | Appointed 1 October 2014 |

**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 2015. 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, business, key performance indicators and principal risks and uncertainties is contained in the Strategic Report on pages 2 to 24 which is incorporated by reference into this report.

**Material interests in shares**

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

**Dividends**

An interim dividend of £655 million was paid during the year (2013/14: £300 million interim dividend). The Directors have not proposed a final dividend.

**Share capital**

Share capital remains unchanged.  See note 19 to the consolidated financial statement for further details.

**Research and development**

Expenditure on research and development was £10 million during the year (2013/14: £6 million).

**Financial instruments**

Details on the use of financial instruments and financial risk management are included in note 24 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 16 and 17 which is 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 Company's Annual General Meeting for 2015 will be issued separately to the shareholder.

**Going concern**

Having made enquiries and reviewed management's assessment of the going concern assumption, the Directors have a reasonable expectation that National Grid Electricity Transmission has adequate resources to continue in operational existence for the next financial year and the foreseeable future. For this reason, the Directors are satisfied that, at the time of approving the financial statements, it is appropriate to continue to adopt the going concern basis in preparing the consolidated and individual financial statements of the Company. More detail on our financial risks, including liquidity and solvency, is provided in note 24 to the consolidated financial statements. There have been no major changes to the Group's significant liquidity and solvency risks in the year.

By order of the Board

**Andy Agg**
Director
1 July 2015
National Grid Electricity Transmission plc
1-3 Strand, London WC2N 5EH
Registered in England and Wales Number 2366977

# Introduction to the financial statements

Throughout these financial statements we have included additional information in highlighted text, providing helpful commentary on what the disclosures mean and why they are important to the understanding of our financial performance and position.

Some of this additional information highlight 'Our strategy in action', drawing out the key elements of our business model (set out in the Strategic Report on pages 2 to 24), and showing how the disclosures reflect this strategy.

## 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 Accounts, including the consolidated financial statements and the Company financial statements, the Directors' Report, and the Strategic Report, in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, and the Company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom generally accepted accounting practice, UK GAAP). In preparing the consolidated financial statements, the Directors have also elected to comply with IFRS, issued by the International Accounting Standards Board (IASB). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company on a consolidated and individual basis and of the profit or loss of the Company on a consolidated basis for that period.

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

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

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company on a consolidated and individual basis, and to enable them to ensure that the consolidated financial statements comply with the Companies Act 2006 and Article 4 of the IAS Regulation and the Company financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and its subsidiaries and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions. Each of the Directors, whose names are listed on page 29, confirms that:

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

On behalf of the Board

**Andy Agg**
Director
1 July 2015

# Independent Auditors' report

to the Members of National Grid Electricity Transmission plc

## Report on the group financial statements

**Our opinion**

In our opinion:

- National Grid Electricity Transmission plc's group financial statements and company financial statements (the "financial statements") give a true and fair view of the state of the group's and of the company's affairs as at 31 March 2015 and of the group's profit and cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union;
- the company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; 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.

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

As explained in the Statement of Directors' responsibilities, the group, in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

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

**What we have audited**

National Grid Electricity Transmission plc's financial statements comprise:

- the consolidated statement of financial position as at 31 March 2015;
- the company balance sheet as at 31 March 2015;
- the consolidated income statement and the consolidated statement of comprehensive income for the year then ended;
- the consolidated cash flow statement for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the basis of preparation, recent accounting developments and company accounting policies; and
- the notes to the financial statements, which include other explanatory information.

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 company financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

## Opinions on other matters prescribed by the Companies Act 2006

In our opinion:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the information given in the Corporate Governance Statement set out on pages 25 to 28 with respect to internal control and risk management systems and about share capital structures is consistent with the financial statements.

## Other matters on which we are required to report by exception

**Adequacy of accounting records and information and explanations received**

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have no exceptions to report arising from this responsibility.

**Directors' remuneration**

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

**Corporate governance statement**

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

## Responsibilities for the financial statements and the audit

**Our responsibilities and those of the directors**

As explained more fully in the Statement of Directors' responsibilities set out on page 31, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

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

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

**What an audit of financial statements involves**

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

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

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

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

Stephen Snook (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Birmingham
1 July 2015

# Basis of preparation

(for National Grid Electricity Transmission)

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

This section also shows areas of judgement and key sources of estimation uncertainty in these financial statements. In addition, we summarise new EU endorsed accounting standards, amendments and interpretations and whether these are effective in 2015 or later years, explaining how significant changes are expected to affect our performance.

National Grid Electricity Transmission plc's principal activities involve the transmission of electricity 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 1 July 2015.

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 2015 and in accordance with the Companies Act 2006 applicable to companies reporting under IFRS and Article 4 of the EU IAS Regulation. The 2014 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.

The consolidated financial statements have been prepared on a going concern basis following the assessment made by the Directors as set out on page 29.These consolidated financial statements are presented in pounds sterling, which is also the functional currency of the Company. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities and the reported amounts of revenue and expenses during the reporting period (see accounting policy C). Actual results could differ from these estimates.

## A. 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.

## B. Foreign currencies

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

Gains and losses arising on the retranslation of monetary assets and liabilities are included in the income statement, except where the adoption of hedge accounting requires inclusion in other comprehensive income - note 10.

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

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

The area of judgement that has the most significant effect on the amounts recognised in the financial statements is detailed below:

- the categorisation of certain items as exceptional items and remeasurements and the definition of adjusted earnings – note 3.

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 7 and 8.
- estimation of liabilities for pensions and other post-retirement benefits – notes 17 and 23.
- valuation of financial instruments and derivatives – notes 10 and 24.
- revenue recognition and assessment of unbilled revenue – note 1.
- environmental and decommissioning provisions – note 18.

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 25.

# Recent accounting developments

## New IFRS accounting standards and interpretations adopted in 2014/15

The following standards, interpretations and amendments, issued by the IASB and by the IFRS Interpretations Committee (IFRIC), are effective for the year ended 31 March 2015. None of the pronouncements has had a material impact on the Company's consolidated results or assets and liabilities for the year ended 31 March 2015.

- IFRIC 21 'Levies';
- amendments to IAS 32 'Financial Instruments: Presentation' in respect of offsetting financial assets and financial liabilities';
- amendments to IFRS 10 'Consolidated Financial Statements', IFRS 12 'Disclosure of Interests in Other Entities' and IAS 27 'Separate Financial Statements' in respect of investment entities;
- amendments to IAS 36 'Impairment of Assets' in respect of recoverable amount disclosures for non-financial assets; and
- amendments to IAS 39 'Financial Instruments: Recognition and Measurement', in respect of novation of derivatives and continuation of hedge accounting.

## 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', effective for periods beginning after 1 January 2018. We are assessing the likely impact of this standard on the Company's financial statements.

IFRS 15 'Revenue from Contracts with Customers' was issued by the IASB in May 2014. Subject to EU endorsement, it is effective for accounting periods beginning on or after 1 January 2017. The new standard provides enhanced detail on the principle of recognising revenue to reflect the transfer of goods and services to customers at a value which the Company expects to be entitled to receive.

The National Grid Group has completed an initial impact assessment of the new standard by completing a survey of all businesses identifying the likely impact of IFRS 15. This was a tailored questionnaire based on the known impacts of the new standard on power and utility companies. Whilst no material differences were identified as part of the questionnaire process, further follow up work will be required to determine the impact, if any, on certain revenue items including, but not limited to, variable consideration contracts, take or pay arrangements and performance obligations where multiple goods or services are provided in individual contracts.

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

# Consolidated income statement

**for the years ended 31 March**

| | Notes | **2015 £m** | **2015 £m** | 2014 £m | 2014 £m |
|---|---|---|---|---|---|
| **Revenue** | 1(a) | | **3,713** | | 3,393 |
| Exceptional other income | 3 | | **43** | | - |
| Operating costs | 2 | | **(2,529)** | | (2,375) |
| **Operating profit** | | | | | |
| Before exceptional items | 1(b) | **1,171** | | 1,078 | |
| Exceptional items | 3 | **56** | | (60) | |
| **Total operating profit** | 1(b) | | **1,227** | | 1,018 |
| Finance income | 4 | | **10** | | 3 |
| Finance costs | | | | | |
| Before exceptional items and remeasurements | 4 | **(156)** | | (191) | |
| Exceptional items and remeasurements | 3, 4 | **(106)** | | 12 | |
| **Total finance costs** | 4 | | **(262)** | | (179) |
| **Profit before tax** | | | | | |
| Before exceptional items and remeasurements | | **1,025** | | 890 | |
| Exceptional items and remeasurements | 3 | **(50)** | | (48) | |
| **Total profit before tax** | | | **975** | | 842 |
| Tax | | | | | |
| Before exceptional items and remeasurements | 5 | **(218)** | | (211) | |
| Exceptional items and remeasurements | 3, 5 | **13** | | 132 | |
| Total tax | 5 | | **(205)** | | (79) |
| **Profit after tax** | | | | | |
| Before exceptional items and remeasurements | | **807** | | 679 | |
| Exceptional items and remeasurements | 3 | **(37)** | | 84 | |
| **Profit for the year attributable to owners of the parent** | | | **770** | | 763 |

# Consolidated statement of comprehensive income

**for the years ended 31 March**

| | Notes | 2015 £m | 2014 £m |
|---|---|---|---|
| **Profit for the year** | | **770** | 763 |
| **Other comprehensive (loss)/income:** | | | |
| Items that will never be reclassified to profit or loss | | | |
| Remeasurements of net retirement benefit obligations | 17 | **61** | 96 |
| Tax on items that will never be reclassified to profit or loss | 5 | **(13)** | (32) |
| **Total items that will never be reclassified to profit or loss** | | **48** | 64 |
| Items that may be reclassified subsequently to profit or loss | | | |
| Net (losses)/gains in respect of cash flow hedges | | **(90)** | 10 |
| Transferred to profit or loss in respect of cash flow hedges | | **8** | 5 |
| Tax on items that may be reclassified subsequently to profit or loss | 5 | **16** | (4) |
| **Total items that may be reclassified subsequently to profit or loss** | | **(66)** | 11 |
| **Other comprehensive (loss)/income for the year, net of tax** | | **(18)** | 75 |
| **Total comprehensive income for the year attributable to owners of the parent** | | **752** | 838 |

The value of derivatives held to hedge cash flows is impacted by changes in expected interest rates and in exchange rates. The net loss for the year was £90m (2014: net gain £10m).

# Consolidated statement of financial position

**as at 31 March**

| | Notes | 2015 £m | 2014 £m |
|---|---|---|---|
| **Non-current assets** | | | |
| Intangible assets | 7 | **174** | 160 |
| Property, plant and equipment | 8 | **11,137** | 10,513 |
| Derivative financial assets | 10 | **402** | 248 |
| Total non-current assets | | **11,713** | 10,921 |
| **Current assets** | | | |
| Inventories | 11 | **30** | 29 |
| Trade and other receivables | 12 | **269** | 241 |
| Financial and other investments | 9 | **478** | 326 |
| Derivative financial assets | 10 | **39** | 21 |
| Current tax asset | | **5** | 3 |
| Cash and cash equivalents | 13 | **3** | - |
| Total current assets | | **824** | 620 |
| **Total assets** | | **12,537** | 11,541 |
| **Current liabilities** | | | |
| Borrowings | 14 | **(1,611)** | (532) |
| Derivative financial liabilities | 10 | **(98)** | (62) |
| Trade and other payables | 15 | **(980)** | (877) |
| Provisions | 18 | **(15)** | (32) |
| Total current liabilities | | **(2,704)** | (1,503) |
| **Non-current liabilities** | | | |
| Borrowings | 14 | **(5,512)** | (6,025) |
| Derivative financial liabilities | 10 | **(625)** | (391) |
| Other non-current liabilities | 16 | **(348)** | (330) |
| Deferred tax liabilities | 5 | **(791)** | (735) |
| Pensions benefit obligations | 17 | **(410)** | (510) |
| Provisions | 18 | **(77)** | (80) |
| Total non-current liabilities | | **(7,763)** | (8,071) |
| **Total liabilities** | | **(10,467)** | (9,574) |
| **Net assets** | | **2,070** | 1,967 |
| **Equity** | | | |
| Share capital | 19 | **44** | 44 |
| Retained earnings | | **2,115** | 1,946 |
| Cash flow hedge reserve | | **(89)** | (23) |
| **Total equity** | | **2,070** | 1,967 |

These consolidated financial statements set out on pages 37 to 74 were approved by the Board of Directors and authorised for issue on 1 July 2015. They were signed on its behalf by:

**Mark Ripley** Director

**Andy Agg** Director

**National Grid Electricity Transmission plc**
Registered number: 2366977

# Consolidated statement of changes in equity

**for the years ended 31 March**

| | Called up share capital £m | Retained earnings £m | Cash flow hedge reserve £m | Total equity £m |
|---|---|---|---|---|
| At 1 April 2013 | 44 | 1,417 | (34) | 1,427 |
| Profit for the year | - | 763 | - | 763 |
| Total other comprehensive income for the year | - | 64 | 11 | 75 |
| Total comprehensive income for the year | - | 827 | 11 | 838 |
| Equity dividends | - | (300) | - | (300) |
| Share-based payment | - | 2 | - | 2 |
| At 31 March 2014 | 44 | 1,946 | (23) | 1,967 |
| Profit for the year | - | 770 | - | 770 |
| Total other comprehensive income/(loss) for the year | - | 48 | (66) | (18) |
| Total comprehensive income/(loss) for the year | - | 818 | (66) | 752 |
| Equity dividends | - | (655) | - | (655) |
| Share-based payment | - | 6 | - | 6 |
| **At 31 March 2015** | **44** | **2,115** | **(89)** | **2,070** |

The cash flow hedge reserve on interest rate swap contracts will be continuously transferred to the income statement until the borrowings are repaid. The amount due to be released from reserves to the income statement next year is £24m, with the remainder due to be released with the same maturity profile as borrowings due after more than one year.

# Consolidated cash flow statement

**for the years ended 31 March**

| | Notes | **2015 £m** | 2014 £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Total operating profit | 1(b) | **1,227** | 1,018 |
| Adjustments for: | | | |
| Exceptional items | 3 | **(56)** | 60 |
| Depreciation and amortisation | | **375** | 341 |
| Share-based payment charge | | **3** | 3 |
| Changes in working capital | | **69** | 54 |
| Changes in pension obligations | | **(58)** | (40) |
| Changes in provisions | | **(23)** | (2) |
| Gain on disposal of property, plant and equipment | | **(2)** | - |
| Cash flows relating to exceptional items | | **113** | (47) |
| Cash flows generated from operations | | **1,648** | 1,387 |
| Tax paid | | **(143)** | (141) |
| **Net cash inflow from operating activities** | | **1,505** | 1,246 |
| **Cash flows from investing activities** | | | |
| Purchases of intangible assets | | **(46)** | (53) |
| Purchases of property, plant and equipment | | **(914)** | (1,145) |
| Disposal of property, plant and equipment | | **4** | 4 |
| Interest received | | **11** | 2 |
| Net movement in short-term financial investments | | **(153)** | 592 |
| **Net cash flow used in investing activities** | | **(1,098)** | (600) |
| **Cash flows from financing activities** | | | |
| Proceeds from loans received | | **642** | 433 |
| Repayment of loans | | **(169)** | (495) |
| Net movements in short-term borrowings and derivatives | | **14** | (89) |
| Interest paid | | **(230)** | (204) |
| Dividends paid to shareholders | | **(655)** | (300) |
| **Net cash flow used in financing activities** | | **(398)** | (655) |
| **Net increase/(decrease) in cash and cash equivalents** | 20(a) | **9** | (9) |
| Cash and cash equivalents at the start of the year | | **(6)** | 3 |
| **Net cash and cash equivalents at the end of the year** | 13 | **3** | (6) |

# 1. Segmental analysis

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

***Our strategy in action***

*We 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 business earns revenue for the transmission services it has provided during the 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 of electricity, together with the sales value derived from the provision of other services to customers during the year. It excludes value added (sales) tax and intra-group sales.

Revenue includes an assessment of unbilled energy and transportation services supplied to customers between the date of the last meter reading and the year end, but not invoiced at year end. This is estimated based on historical consumption and weather patterns.

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

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 Electricity Transmission 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). The following table describes the main activities for each operating segment:

| | |
|---|---|
| Electricity Transmission | High voltage electricity transmission networks in Great Britain. |

Other activities relate to other commercial operations not included within the above segment and corporate activities.

All of the Group's sales and operations take place within the UK.

**(a) Revenue**

| | **2015 Total sales £m** | 2014 Total sales £m |
|---|---|---|
| Operating segment | | |
| Electricity Transmission | **3,712** | 3,392 |
| Other activities | **1** | 1 |
| | **3,713** | 3,393 |

All sales are to third parties.

| **Analysis of revenue by major customer:** | **2015 £m** | 2014 £m |
|---|---|---|
| Customer A | **705** | 422 |
| Customer B | **470** | 450 |

No other single customer contributed 10% or more to the Group's revenue in either 2015 or 2014.

# 1. Segmental analysis (continued)

**(b) Operating profit/(loss)**

| | Before exceptional items and remeasurements | | After exceptional items and remeasurements | |
|---|---|---|---|---|
| | **2015 £m** | 2014 £m | **2015 £m** | 2014 £m |
| Operating segment | | | | |
| Electricity Transmission | **1,182** | 1,087 | **1,238** | 1,027 |
| Other activities | **(11)** | (9) | **(11)** | (9) |
| | **1,171** | 1,078 | **1,227** | 1,018 |
| Reconciliation to profit before tax: | | | | |
| Operating profit | **1,171** | 1,078 | **1,227** | 1,018 |
| Finance income | **10** | 3 | **10** | 3 |
| Finance costs | **(156)** | (191) | **(262)** | (179) |
| **Profit before tax** | **1,025** | 890 | **975** | 842 |

**(c) Capital expenditure and depreciation**

| | Capital expenditure | | Depreciation and amortisation | |
|---|---|---|---|---|
| | **2015 £m** | 2014 £m | **2015 £m** | 2014 £m |
| Operating segment | | | | |
| Electricity Transmission | **1,072** | 1,381 | **375** | 343 |
| | **1,072** | 1,381 | **375** | 343 |
| By asset type | | | | |
| Property, plant and equipment | **1,026** | 1,328 | **355** | 327 |
| Intangible assets | **46** | 53 | **20** | 16 |
| | **1,072** | 1,381 | **375** | 343 |

## 2. Operating costs

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

| | Before exceptional items and remeasurements | | Exceptional items and remeasurements | | Total | |
|---|---|---|---|---|---|---|
| | **2015 £m** | 2014 £m | **2015 £m** | 2014 £m | **2015 £m** | 2014 £m |
| Depreciation and amortisation | **375** | 343 | **-** | - | **375** | 343 |
| Payroll costs | **141** | 91 | **-** | 39 | **141** | 130 |
| Rates | **83** | 88 | **-** | - | **83** | 88 |
| Balancing Service Incentive Scheme | **874** | 872 | **-** | - | **874** | 872 |
| Payments to other UK network owners | **801** | 630 | **-** | - | **801** | 630 |
| Other | **268** | 291 | **(13)** | 21 | **255** | 312 |
| | **2,542** | 2,315 | **(13)** | 60 | **2,529** | 2,375 |

### (a) Payroll costs

| | **2015 £m** | 2014 £m |
|---|---|---|
| Wages and salaries | **155** | 156 |
| Social security costs | **21** | 19 |
| Pension costs (note 17) | **33** | 50 |
| Share-based payment | **6** | 2 |
| Severance costs (excluding pension costs) | **1** | 18 |
| | **216** | 245 |
| Less: payroll costs capitalised | **(75)** | (115) |
| | **141** | 130 |

### (b) Number of employees, including Directors

| | **31 March 2015 Number** | **Monthly average 2015 Number** | 31 March 2014 Number (i) | Monthly average 2014 Number (i) |
|---|---|---|---|---|
| UK | **3,270** | **3,273** | 3,324 | 3,384 |

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

The vast majority of employees are either directly or indirectly employed in the transmission of electricity.

### (c) Key management compensation

| | **2015 £m** | 2014 £m |
|---|---|---|
| Salaries and short-term employee benefits | **4** | 3 |
| Post-retirement benefits | **4** | 1 |
| Share-based payment | **1** | 2 |
| Termination benefits (i) | **-** | - |
| | **9** | 6 |

(i). See note 2(d) for details of termination benefits

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 Electricity Transmission plc.

## 2. Operating costs (continued)

**(d) Directors' emoluments**

The aggregate amount of emoluments paid (excluding social security, pensions and share-based payment) to Directors of the company in respect of qualifying services for 2015 was £1,470,019 (2014: £1,609,751).

Eight of the directors exercised share options during 2015 including the highest paid director (2014: Five of the directors exercised share options).

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 2015, retirement benefits were accruing to seven Directors under a defined benefit scheme (2014: four directors, under a defined benefit scheme).

The aggregate emoluments for the highest paid Director were £508,018 for 2015 (2014: £756,958); and total accrued annual pension at 31 March 2015 for the highest paid Director was £71,250 (2014: £170,342).

The aggregate amount of loss of office payments to Directors for 2015 was £155,393 (2014: £nil).

**(e) Auditors' remuneration**

| | **2015** **£m** | 2014 £m |
|---|---|---|
| Audit services | | |
| Audit of the parent Company's individual and consolidated financial statements | **0.2** | 0.2 |
| Other services supplied | | |
| Fees payable to the Company's auditors for audit related assurance services | **0.3** | 0.1 |

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. In particular this includes fees for audit reports on regulatory returns.These fees have been subject to approval by the Audit Committee.

## 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'. We exclude items from business performance because we think these items are individually important to understanding our financial performance and, if included, could distort understanding of the 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.

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 provisions, integration of acquired businesses, gains or losses on disposals of businesses or investments and significant debt redemption costs as a consequence of transactions such as significant disposals or issues of equity.

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

Remeasurements comprise gains or losses recorded in the income statement arising from changes in the fair value 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.

| | **2015** **£m** | 2014 £m |
|---|---|---|
| **Included within operating profit:** | | |
| *Exceptional items:* | | |
| Restructuring costs (i) | **-** | (60) |
| Legal settlements (ii) | **56** | - |
| | **56** | (60) |
| **Included within finance costs:** | | |
| *Exceptional items:* | | |
| Debt redemption costs (iii) | **(63)** | - |
| *Remeasurements:* | | |
| Net (losses)/gains on derivative financial instruments (iv) | **(43)** | 12 |
| | **(106)** | 12 |
| **Total included within profit before tax** | **(50)** | (48) |
| **Included within tax:** | | |
| *Exceptional credits arising on items not included in profit before tax:* | | |
| Deferred tax credit arising on the reduction in UK corporation tax rate (v) | **3** | 121 |
| Tax on exceptional items (i), (ii) & (iii) | **1** | 14 |
| Tax on remeasurements (iv) | **9** | (3) |
| | **13** | 132 |
| **Total exceptional items and remeasurements after tax** | **(37)** | 84 |
| **Analysis of total exceptional items and remeasurements after tax:** | | |
| Total exceptional items after tax | **(3)** | 75 |
| Total remeasurements after tax | **(34)** | 9 |
| **Total** | **(37)** | 84 |

(i) No exceptional restructuring costs have been incurred in the year ended 31 March 2015. Restructuring costs for 2014 included: costs related to the continued restructuring of our UK operations in preparation to deliver RIIO, and other transformation-related initiatives.

(ii) During the year ended 31 March 2015, the Group received £113m for settlement of legal claims relating to equipment procured in prior years. £13m has been credited to operating costs, £43m has been recognised as other income and £57m has been credited to plant and machinery within tangible fixed assets. There were no similar items for the year ended 31 March 2014.

(iii) Represents costs arising from a liability management programme. We have reviewed and restructured the Group debt portfolio following the commencement of the RIIO price controls in 2013 and the slow down in our planned short term UK capital investment programme as the industry assesses the impact of EMR. This resulted in a bond repurchase programme with a notional value of £169m.

(iv) Remeasurements - net (losses)/gains on derivative financial instruments comprise (losses)/gains arising on derivative financial instruments reported in the income statement. These exclude gains and losses for which hedge accounting has been effective, which have been recognised directly in other comprehensive income or which are offset by adjustments to the carrying value of debt.

(v) The Finance Act 2013 enacted reductions in the UK corporation tax rate from 23% to 21% from 1 April 2014, and from 21% to 20% from 1 April 2015. Other UK tax legislation also reduced the UK corporation tax rate in prior periods (2013: from 24% to 23%). These reductions have resulted in decreases to UK deferred tax liabilities in these periods.

## 4. Finance income and costs

**This note details the interest income generated by our financial assets and interest expense incurred on our financial liabilities. It also includes the expected return on pension assets, which is offset by the interest payable on pension obligations and presented on a net basis. In reporting business performance, we adjust net financing costs to exclude any net gains or losses on derivative financial instruments included in remeasurements. In addition, the current year debt redemption costs have been treated as exceptional (see note 3).**

| | 2015 £m | 2014 £m |
|---|---|---|
| **Finance income** | | |
| *Interest income on financial instruments:* | | |
| Bank deposits and other financial assets | **10** | 3 |
| | **10** | 3 |
| **Finance costs** | | |
| Net interest on pension obligations | **(19)** | (26) |
| *Interest expense on finance liabilities held at amortised cost:* | | |
| Bank loans and overdrafts | **(5)** | (9) |
| Other borrowings | **(247)** | (296) |
| Derivatives | **24** | 25 |
| Unwinding of discount on provisions | **(3)** | (4) |
| Less: interest capitalised (i) | **94** | 119 |
| | **(156)** | (191) |
| **Exceptional items:** | | |
| Debt redemption costs | **(63)** | - |
| **Remeasurements:** | | |
| Net gains/(losses) on derivative financial instruments included in remeasurements (ii): | | |
| *Ineffectiveness on derivatives designated as:* | | |
| Fair value hedges (iii) | **10** | (2) |
| Cash flow hedges | **(7)** | (3) |
| Derivatives not designated as hedges or ineligible for hedge accounting | **(46)** | 17 |
| | **(106)** | 12 |
| | **(262)** | (179) |
| **Net finance costs** | **(252)** | (176) |

(i) Interest on funding attributable to assets in the course of construction was capitalised during the year at a rate of 3.9% (2014: 4.8%). Capitalised interest qualifies for a current year tax deduction with tax relief claimed of £20m (2014: £27m).

(ii) Includes a net foreign exchange gain on financing activities of £61m (2014: £203m). These amounts are offset by foreign exchange gains and losses on derivative financial instruments measured at fair value.

(iii) Includes a net gain on instruments designated as fair value hedges of £102m (2014: £72m loss), offset by a net loss of £87m (2014: £70m gain) arising from the fair value adjustments to the carrying value of debt.

## 5. Tax

**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 of profit.**

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

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

The calculation of the 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 Group and its subsidiaries intend to settle their current tax assets and liabilities on a net basis.

**Tax charged to the income statement**

| | **2015 £m** | 2014 £m |
|---|---|---|
| Tax before exceptional items and remeasurements | **218** | 211 |
| Exceptional tax on items not included in profit before tax (note 3) | **(3)** | (121) |
| Tax on other exceptional items and remeasurements (note 3) | **(10)** | (11) |
| Tax on total exceptional items and remeasurements (note 3) | **(13)** | (132) |
| **Total tax charge** | **205** | 79 |

**Tax as a percentage of profit before tax**

| | **2015 %** | 2014 % |
|---|---|---|
| Before exceptional items and remeasurements | **21.3** | 23.7 |
| After exceptional items and remeasurements | **21.0** | 9.4 |

| The tax charge for the year can be analysed as follows: | **2015 £m** | 2014 £m |
|---|---|---|
| *Current tax* | | |
| Corporation tax at 21% (2014: 23%) | **152** | 133 |
| Corporation tax adjustment in respect of prior years | **(7)** | (4) |
| *Total current tax* | **145** | 129 |
| *Deferred tax* | | |
| Deferred tax | **54** | (53) |
| Deferred tax adjustment in respect of prior years | **6** | 3 |
| *Total deferred tax* | **60** | (50) |
| **Total tax charge** | **205** | 79 |

## 5. Tax (continued)

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

| | 2015 £m | 2014 £m |
|---|---|---|
| *Current tax* | | |
| Share-based payment | **(3)** | - |
| *Deferred tax* | | |
| Cash flow hedges | **(16)** | 4 |
| Share-based payment | **(1)** | - |
| Remeasurements of net retirement benefit obligations | **13** | 32 |
| | **(7)** | 36 |
| Analysed as: | | |
| Total tax recognised in the statement of other comprehensive income | **(3)** | 36 |
| Total tax relating to share-based payment recognised directly in equity | **(4)** | - |
| | **(7)** | 36 |

The tax charge for the year after exceptional items and remeasurements is the same as (2014: lower than) the standard rate of corporation tax in the UK of 21% (2014: 23%):

| | Before exceptional items and remeasure-ments 2015 £m | After exceptional items and remeasure-ments 2015 £m | Before exceptional items and remeasure-ments 2014 £m | After exceptional items and remeasure-ments 2014 £m |
|---|---|---|---|---|
| Profit before tax | | | | |
| Before exceptional items and remeasurements | **1,025** | **1,025** | 890 | 890 |
| Exceptional items and remeasurements | **-** | **(50)** | - | (48) |
| Profit before tax | **1,025** | **975** | 890 | 842 |
| Profit before tax multiplied by UK corporation tax rate of 21% (2014: 23%) | **215** | **205** | 205 | 194 |
| Effect of: | | | | |
| Adjustments in respect of prior years | **(1)** | **(1)** | (1) | (1) |
| Expenses not deductible for tax purposes | **7** | **7** | 6 | 6 |
| Impact of share-based payment | **(3)** | **(3)** | 1 | 1 |
| Deferred tax impact of change in UK tax rate | **-** | **(3)** | - | (121) |
| Total tax charge | **218** | **205** | 211 | 79 |
| | **%** | **%** | % | % |
| Effective tax rate | **21.3** | **21.0** | 23.7 | 9.4 |

## 5. Tax (continued)

**Tax included within the statement of financial position**
The following are the major deferred tax assets and liabilities recognised, and the movements thereon, during the current and prior reporting periods:

**Deferred tax (assets)/liabilities**

| | Accelerated tax depreciation £m | Share-based payment £m | Pensions £m | Financial instruments £m | Other net temporary differences £m | Total £m |
|---|---|---|---|---|---|---|
| Deferred tax assets at 31 March 2013 | - | (5) | (143) | (10) | (4) | (162) |
| Deferred tax liabilities at 31 March 2013 | 910 | - | - | - | 1 | 911 |
| At 1 April 2013 as previously reported | 910 | (5) | (143) | (10) | (3) | 749 |
| (Credited)/charged to income statement | (58) | 1 | 9 | - | (2) | (50) |
| Charged to other comprehensive income | - | - | 32 | 4 | - | 36 |
| At 31 March 2014 | 852 | (4) | (102) | (6) | (5) | 735 |
| Deferred tax assets at 31 March 2014 | - | (4) | (102) | (6) | (6) | (118) |
| Deferred tax liabilities at 31 March 2014 | 852 | - | - | - | 1 | 853 |
| At 1 April 2014 | 852 | (4) | (102) | (6) | (5) | 735 |
| Charged/(credited) to income statement | 50 | (1) | 8 | - | 3 | 60 |
| (Credited)/charged to other comprehensive income | - | (1) | 13 | (16) | - | (4) |
| **At 31 March 2015** | **902** | **(6)** | **(81)** | **(22)** | **(2)** | **791** |
| Deferred tax assets at 31 March 2015 | - | (6) | (81) | (22) | (3) | (112) |
| Deferred tax liabilities at 31 March 2015 | 902 | - | - | - | 1 | 903 |
| **At 31 March 2015** | **902** | **(6)** | **(81)** | **(22)** | **(2)** | **791** |

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is intention to settle the balances net. The deferred tax balances (after offset) for statement of financial position purposes consist solely of deferred tax liabilities of £791m (2014: £735m).

## 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 pay out the remainder in accordance with our dividend policy.**
Interim dividends are recognised when they become payable to the Company's shareholder. Final dividends are recognised when they are approved by shareholders.

The following table shows the dividends paid to equity shareholders:

| | **2015** | | 2014 | |
|---|---|---|---|---|
| | **pence (per ordinary share)** | **£m** | pence (per ordinary share) | £m |
| **Ordinary dividends** | | | | |
| Interim dividend paid in the year | **149.79** | **655** | 68.61 | 300 |

# 7. Intangible assets

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

Identifiable intangible assets are recorded at cost less accumulated amortisation and any provision for impairment.
Other intangible assets are tested for impairment only if there is 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 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 principal amortisation period for software is up to 8 years.

| | Software £m |
|---|---|
| Cost at 1 April 2013 | 198 |
| Additions | 53 |
| Reclassifications between categories (i) | 35 |
| Cost at 31 March 2014 | 286 |
| Additions | 46 |
| Reclassifications between categories (i) | (6) |
| Cost at 31 March 2015 | 326 |
| Accumulated amortisation at 1 April 2013 | (109) |
| Amortisation charge for the year | (16) |
| Reclassifications between categories (i) | (1) |
| Accumulated amortisation at 31 March 2014 | (126) |
| Amortisation charge for the year | (20) |
| Reclassifications between categories (i) | (6) |
| Accumulated amortisation at 31 March 2015 | (152) |
| **Net book value at 31 March 2015** | **174** |
| Net book value at 31 March 2014 | 160 |

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

## 8. 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.**

***Our strategy in action***

*We operate an electricity transmission business and therefore have a significant physical asset base. We continue to invest in our networks to maintain reliability, create new customer connections and ensure our networks have the flexibility and resilience. 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.

Property, plant and equipment includes assets in which the Group's interest comprises legally protected statutory or contractual rights of use.

Additions represent the purchase or construction of new assets, including capital expenditure for safety and environmental assets, and extensions to, enhancements to, or replacement of existing assets.

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

Contributions received post 1 July 2009 are recognised in revenue immediately, except where the contributions are consideration for a future service, in which case they are recognised initially as deferred income and revenue is subsequently recognised over the period in which the service is provided. No depreciation is provided on freehold land or assets in the course of construction.

Other items of property, plant and equipment are depreciated, on a straight-line basis, at rates estimated to write off their book values over their estimated useful economic lives. In assessing estimated useful economic lives, consideration is given to any contractual arrangements and operational requirements relating to particular assets. The assessments of estimated useful economic lives and residual values of assets are performed annually. Unless otherwise determined by operational requirements, the depreciation periods for the principal categories of property, plant and equipment are, in general, as shown in the table below:

| **Depreciation periods** | Years |
|---|---|
| Freehold and leasehold buildings | up to 50 |
| Plant and Machinery | |
| - Electricity Transmission plant | 15 to 60 |
| Motor vehicles and office equipment | up to 7 |

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

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

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

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

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

## 8. 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 2013 | 515 | 10,109 | 2,539 | 103 | 13,266 |
| Additions | 23 | 33 | 1,271 | 1 | 1,328 |
| Disposals | - | (97) | (2) | (5) | (104) |
| Reclassifications between categories (i) | (48) | 998 | (972) | (13) | (35) |
| Cost at 31 March 2014 | 490 | 11,043 | 2,836 | 86 | 14,455 |
| Additions | 3 | 63 | 956 | 4 | 1,026 |
| Disposals | - | (18) | (1) | (3) | (22) |
| Reclassifications between categories (i) | 62 | 500 | (556) | - | 6 |
| Other movements (ii) | - | (57) | - | - | (57) |
| Cost at 31 March 2015 | 555 | 11,531 | 3,235 | 87 | 15,408 |
| Accumulated depreciation at 1 April 2013 | (65) | (3,590) | - | (63) | (3,718) |
| Depreciation charge for the year | (14) | (304) | - | (9) | (327) |
| Disposals | - | 97 | - | 5 | 102 |
| Reclassifications between categories (i) | 4 | (4) | - | 1 | 1 |
| Accumulated depreciation at 31 March 2014 | (75) | (3,801) | - | (66) | (3,942) |
| Depreciation charge for the year | (15) | (330) | - | (10) | (355) |
| Disposals | - | 18 | - | 2 | 20 |
| Reclassifications between categories (i) | (2) | 2 | - | 6 | 6 |
| Accumulated depreciation at 31 March 2015 | (92) | (4,111) | - | (68) | (4,271) |
| **Net book value at 31 March 2015** | **463** | **7,420** | **3,235** | **19** | **11,137** |
| Net book value at 31 March 2014 | 415 | 7,242 | 2,836 | 20 | 10,513 |

(i) Reclassifications represents amounts transferred between categories and (to)/from intangible assets (see note 7).

(ii) Credit relating to settlement of legal claims relating to equipment procurement (see note 3).

| | **2015 £m** | 2014 £m |
|---|---|---|
| **Information in relation to property, plant and equipment:** | | |
| Capitalised interest included within cost | **1,134** | 1,040 |
| Contributions to cost of property, plant and equipment included within: | | |
| Trade and other payables | **7** | 7 |
| Non-current liabilities | **308** | 295 |

## 9. Financial and other investments

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

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.

| | **2015 £m** | 2014 £m |
|---|---|---|
| **Current** | | |
| Loans and receivables - amounts due from fellow subsidiaries | **1** | 3 |
| Loans and receivables - restricted cash balances (i) | **443** | 289 |
| Available-for-sale investments (ii) | **34** | 34 |
| Total financial and other investments | **478** | 326 |

(i) Comprises collateral placed with counterparties with whom we have entered into a credit support annex to the ISDA Master Agreement £442m (2014: £288m) and secured bank accounts with charges in favour of the UK pension schemes Trustees of £1m (2014: £1m).

(ii) Refers to assets held within security accounts with charges in favour of the UK pension scheme Trustees of £nil (2014: £34m).

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.

## 10. Derivative financial instruments

**Derivatives are financial instruments that derive their value from the price of an underlying item such as interest rates, foreign exchange, credit spreads, equity or other indices. In accordance with the National Grid Board approved policies, derivatives are transacted to manage our exposure to fluctuations in interest rate and foreign exchange rate on borrowings and other contractual cash flows. Specifically, we use derivatives to manage these risks from our financing portfolio to optimise the overall cost of accessing the debt capital markets. These derivatives are analysed below.**

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

We calculate fair value of the financial derivatives by discounting all future cash flows by 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 24.

## 10. Derivative financial instruments (continued)

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

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | **Assets £m** | **Liabilities £m** | **Total £m** | Assets £m | Liabilities £m | Total £m |
| Interest rate swaps | **400** | **(347)** | **53** | 245 | (195) | 50 |
| Cross-currency interest rate swaps | **39** | **(152)** | **(113)** | 23 | (145) | (122) |
| Foreign exchange forward contracts | **2** | **(37)** | **(35)** | 1 | (12) | (11) |
| Inflation linked swaps | **-** | **(187)** | **(187)** | - | (101) | (101) |
| **Total** | **441** | **(723)** | **(282)** | 269 | (453) | (184) |

The maturity of derivative financial instruments is as follows:

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | **Assets £m** | **Liabilities £m** | **Total £m** | Assets £m | Liabilities £m | Total £m |
| **Current** | **39** | **(98)** | **(59)** | 21 | (62) | (41) |
| In 1 - 2 years | **9** | **(27)** | **(18)** | 20 | (5) | 15 |
| In 2 - 3 years | **-** | **(96)** | **(96)** | 9 | (25) | (16) |
| In 3 - 4 years | **-** | **(30)** | **(30)** | 2 | (87) | (85) |
| In 4 - 5 years | **-** | **(34)** | **(34)** | - | (16) | (16) |
| More than 5 years | **393** | **(438)** | **(45)** | 217 | (258) | (41) |
| **Non-current** | **402** | **(625)** | **(223)** | 248 | (391) | (143) |
| **Total** | **441** | **(723)** | **(282)** | 269 | (453) | (184) |

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

| | **2015 £m** | 2014 £m |
|---|---|---|
| Interest rate swaps | **(3,731)** | (3,804) |
| Cross-currency interest rate swaps | **(1,336)** | (1,336) |
| Foreign exchange forward contracts | **(449)** | (533) |
| Inflation linked swaps | **(622)** | (630) |
| **Total** | **(6,138)** | (6,303) |

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

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

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

*Fair value hedges*

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

| | **2015 £m** | 2014 £m |
|---|---|---|
| Cross-currency interest rate/interest rate swaps | **10** | 8 |

## 10. Derivative financial instruments (continued)

*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.

| | **2015 £m** | 2014 £m |
|---|---|---|
| Cross-currency interest rate/interest rate swaps | **(106)** | (73) |
| Foreign exchange forward contracts | **(35)** | (11) |
| Inflation linked swaps | **(47)** | (11) |
| **Cash flow hedges** | **(188)** | (95) |

*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.

| | **2015 £m** | 2014 £m |
|---|---|---|
| Cross-currency interest rate/interest rate swaps | **36** | (7) |
| Inflation linked swaps | **(140)** | (90) |
| **Derivatives not in a formal hedge relationship** | **(104)** | (97) |

*Discontinuation of hedge accounting*

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, exercised or no longer qualifies for hedge accounting. At that time, any cumulative gains or losses relating to cash flow hedges recognised in equity are initially retained in equity and subsequently recognised in the income statement in the same periods in which the previously hedged item affects net profit or loss. 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 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.

## 11. Inventories

**Inventories represent assets that we intend to use in order to generate revenue in future periods, either by selling the asset itself or by using it to fulfil a service to a customer (consumables) or to maintain our network.**
Inventories, which comprise raw materials, spares and consumables, are stated at cost, calculated on a weighted average basis, less provision for damage and obsolescence.

Cost comprises direct materials and those costs that have been incurred in bringing the inventories to their present location and condition.

| | 2015 £m | 2014 £m |
|---|---|---|
| Raw materials, spares and consumables | **30** | 29 |

The above table includes a £16m provision for obsolescence against raw materials and consumables at 31 March 2015 (2014: £16m).

## 12. 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.

| | 2015 £m | 2014 £m |
|---|---|---|
| Trade receivables | **47** | 26 |
| Amounts owed by fellow subsidiaries of National Grid plc | **40** | 16 |
| Prepayments and accrued income | **178** | 194 |
| Other receivables | **4** | 5 |
| | **269** | 241 |

Trade receivables are non-interest bearing and generally have a 30-90 day term. Due to their short maturities, the fair value of trade and other receivables approximates to their book value. All other receivables are recorded at amortised cost. The provision as at 31 March 2015 was £1m (2014: £1m).

## 13. Cash and cash equivalents

**Cash and cash equivalents includes cash balances, together with short-term investments with a maturity of less than three months that are readily convertible to cash.**
Net cash and cash equivalents reflected in the cash flow statement are net of bank overdrafts, which are reported in borrowings.
The carrying amounts of cash and cash equivalents and bank overdrafts approximate their fair values.
Cash at bank earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for periods varying between one day and three months, depending on the immediate cash requirements, and earn interest at the respective short-term deposit rates.
Net cash and cash equivalents held in currencies other than sterling have been converted into sterling at year-end exchange rates. For further information on currency exposures, refer to note 24(d).

| | 2015 £m | 2014 £m |
|---|---|---|
| Cash at bank and short-term deposits | 3 | - |
| **Cash and cash equivalents excluding bank overdrafts** | **3** | - |
| Bank overdrafts | **-** | (6) |
| **Net cash and cash equivalents** | **3** | (6) |

The carrying amounts of net cash and cash equivalents approximate to their fair value.

## 14. Borrowings

**We borrow money primarily in the form of bonds and bank loans. These are for a fixed term and may have fixed or floating interest rates or are linked to the Retail Price Index (RPI). As indicated in note 10, we use derivatives to manage risks associated with interest rates and foreign exchange.**

***Our strategy in action***

*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 level of debt is expected to increase over time. To maintain a strong balance sheet and to allow us to access capital markets at commercially acceptable interest rates, we balance the amount of debt we issue with the value of our assets and take account of certain other metrics used by credit rating agencies.*

Borrowings, which include interest-bearing loans 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.

| | **2015 £m** | 2014 £m |
|---|---|---|
| **Current** | | |
| Bank overdrafts | **-** | 6 |
| Bank loans | **71** | 51 |
| Bonds | **175** | 60 |
| Borrowings from fellow subsidiaries of National Grid plc | **1,365** | 415 |
| | **1,611** | 532 |
| **Non-current** | | |
| Bank loans | **412** | 410 |
| Bonds | **5,100** | 5,310 |
| Borrowings from fellow subsidiaries of National Grid plc | **-** | 305 |
| | **5,512** | 6,025 |
| **Total** | **7,123** | 6,557 |

| Total borrowings are repayable as follows: | **2015 £m** | 2014 £m |
|---|---|---|
| Less than 1 year | **1,611** | 532 |
| In 1 - 2 years | **200** | 127 |
| In 2 - 3 years | **516** | 200 |
| In 3 - 4 years | **515** | 524 |
| In 4 - 5 years | **218** | 516 |
| More than 5 years other than by instalments | **4,063** | 4,658 |
| | **7,123** | 6,557 |

The fair value of borrowings at 31 March 2015 was £8,354m (2014: £7,190m). Where market values were available, fair value of borrowings (Level 1) was £3,930m (2014: £3,996m). Where market values are not available, fair value of borrowings (Level 2) was £4,424m (2014: £3,194m), calculated by discounting cash flows at prevailing interest rates. The notional amount outstanding of the debt portfolio as at 31 March 2015 was £6,882m (2014: £6,400m).

In addition to the above the Company has an RPI - linked bank loan agreement totalling £1.5bn with the European Investment Bank (EIB), which is currently undrawn.

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 £71m (2014: £51m) in respect of cash received under collateral agreements.

At 31 March 2015, we had committed credit facilities of £820m (2014: £820m) of which £820m was undrawn (2014: £820m undrawn). All of the unused facilities at 31 March 2015 and at 31 March 2014 were held as back up to commercial paper and similar borrowings.

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

## 15. Trade and other payables

**Trade and other payables includes amounts owed to suppliers, tax authorities and other parties which are due to be settled within 12 months. The total also includes deferred income, which represents monies received from customers but for which we have not yet completed the associated service. These amounts are recognised as revenue when the service is provided.**
Trade payables are initially recognised at fair value and subsequently measured at amortised cost.

| | 2015 £m | 2014 £m |
|---|---|---|
| Trade payables | **596** | 603 |
| Amounts owed to fellow subsidiaries of National Grid plc | **115** | 77 |
| Deferred income | **113** | 110 |
| Social security and other taxes | **104** | 52 |
| Other payables | **52** | 35 |
| | **980** | 877 |

Due to their short maturities, the fair value of trade and other payables (excluding deferred income) approximates to their book value. All trade and other payables are recorded at amortised cost.

## 16. Other non-current liabilities

**Other non-current liabilities includes deferred income which will not be recognised as income until after 31 March 2016. It also includes payables that are not due until after that date.**

| | 2015 £m | 2014 £m |
|---|---|---|
| Deferred income | **330** | 315 |
| Other payables | **18** | 15 |
| | **348** | 330 |

The fair value of other payables approximates to their book value. All other non-current liabilities are recorded at amortised cost.

## 17. Pensions

**Many of National Grid Electricity Transmission's employees are members of the National Grid Electricity Group of the Electricity Supply Pension Scheme, which is a defined benefit scheme or The National Grid YouPlan (YouPlan) which is a defined contribution trust. 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 enrolled into YouPlan.**

**The fair value of defined benefit scheme assets and present value of defined benefit obligations are updated annually. For further details of the National Grid Electricity Group of the Electricity Supply Pension Scheme terms and the actuarial assumptions used to value the associated assets and obligations, see note 23.**

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

For defined contribution plans, 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 the 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 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 liability recognised in the statement of financial position.

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 of the scheme. A number of further strategies are employed to manage underlying risks, including liability matching asset strategies, diversification of asset portfolios, interest rate hedging and active management of foreign exchange exposure.

**Amounts recognised in the statement of financial position**

| | **2015** | 2014 |
|---|---|---|
| | **£m** | £m |
| Present value of funded obligations | **(2,817)** | (2,433) |
| Fair value of scheme assets | **2,450** | 1,957 |
| | **(367)** | (476) |
| Present value of unfunded obligations | **(43)** | (34) |
| **Net defined benefit liability** | **(410)** | (510) |
| Represented by: | | |
| Liabilities | **(410)** | (510) |
| | **(410)** | (510) |

## 17. Pensions (continued)

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

| | 2015 £m | 2014 £m |
|---|---|---|
| **Included within payroll costs** | | |
| Defined contribution scheme costs | **11** | 9 |
| *Defined benefit scheme costs:* | | |
| Current service cost | **23** | 35 |
| Contributions from other employers | **(11)** | (9) |
| Past service credit - redundancies | **-** | (10) |
| Special termination benefit cost - redundancies | **6** | 21 |
| Past service cost - augmentations | **4** | 8 |
| Past service credit - plan amendments | **-** | (4) |
| | **33** | 50 |
| **Included within finance income and costs** | | |
| Interest cost | **19** | 26 |
| **Total included in the income statement** | **52** | 76 |
| Remeasurements of net retirement benefit obligations | **61** | 96 |
| **Total included in the statement of other comprehensive income** | **61** | 96 |

**Reconciliation of the net defined benefit liability**

| | 2015 £m | 2014 £m |
|---|---|---|
| Opening net defined benefit liability | (510) | (620) |
| Cost recognised in the income statement | (52) | (76) |
| Remeasurement effects recognised in the statement of other comprehensive income | 61 | 96 |
| Employer contributions | 91 | 90 |
| **Closing net defined benefit liability** | **(410)** | (510) |

| | £m | £m |
|---|---|---|
| **Changes in the present value of defined benefit obligations (including unfunded obligations)** | | |
| Opening defined benefit obligations | **(2,467)** | (2,563) |
| Current service cost | **(23)** | (35) |
| Interest cost | **(103)** | (108) |
| Actuarial (losses)/gains - experience | **(13)** | 16 |
| Actuarial losses - demographic assumptions | **(7)** | - |
| Actuarial (losses)/gains - financial assumptions | **(351)** | 128 |
| Past service credit - redundancies | **-** | 10 |
| Special termination benefit cost - redundancies | **(6)** | (21) |
| Past service cost - augmentations | **(4)** | (8) |
| Past service credit - plan amendments | **-** | 4 |
| Employee contributions | **(1)** | (1) |
| Benefits paid | **115** | 111 |
| Closing defined benefit obligations | **(2,860)** | (2,467) |
| **Changes in the fair value of plan assets** | | |
| Opening fair value of plan assets | **1,957** | 1,943 |
| Interest income | **84** | 82 |
| Return on assets greater/(less) than assumed | **432** | (48) |
| Employer contributions | **91** | 90 |
| Employee contributions | **1** | 1 |
| Benefits paid | **(115)** | (111) |
| Closing fair value of plan assets | **2,450** | 1,957 |
| **Actual return on plan assets** | **516** | 34 |
| **Expected contributions to plans in the following year** | **74** | 69 |

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

***Our strategy in action***

*We are committed to the protection and enhancement of the environment. However, we have acquired, owned and operated a number of 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 environmental costs, based on future estimated expenditures, discounted to present values. An initial estimate of environmental costs attributable to property, plant and equipment is recorded as part of the original cost of the related property, plant and Changes in the provision arising from revised estimates or discount rates or changes in the expected timing of expenditures that relate to property, plant and equipment are recorded as adjustments to their carrying value and depreciated prospectively over their remaining estimated useful economic lives; otherwise such changes are recognised in the income statement.
The unwinding of the discount is included within the income statement as a financing charge.

| | Environmental £m | Other £m | Total provisions £m |
|---|---|---|---|
| At 1 April 2013 | 71 | 26 | 97 |
| Additions | - | 43 | 43 |
| Utilised | (1) | (30) | (31) |
| Unwinding of discount | 4 | - | 4 |
| Unused amounts reversed | - | (1) | (1) |
| At 31 March 2014 | 74 | 38 | 112 |
| Utilised | (1) | (17) | (18) |
| Unwinding of discount | 3 | - | 3 |
| Unused amounts reversed | (4) | (1) | (5) |
| **At 31 March 2015** | **72** | **20** | **92** |

| | **2015 £m** | 2014 £m |
|---|---|---|
| Current | **15** | 32 |
| Non-current | **77** | 80 |
| | **92** | 112 |

**Environmental provision**

The environmental provision is calculated on an discounted basis and represents the estimated environmental restoration and remediation costs relating to a number of sites owned and managed by the Company. Cash flows are expected to be incurred between 2015 and 2060. The undiscounted amount is £104m (2014: £107m), and the real discount rate is 2.0%.

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 have a material impact on the calculation of the provision and hence the income statement.

**Other provisions**

Other provisions include employer liability claims of £6m (2014: £6m). In accordance with insurance industry practice, these estimates are based on experience from previous years and there is therefore no identifiable payment date. Also included are business reorganisation costs of £9m, which are expected to be utilised during 2015. The remainder is expected to be incurred until 2023.

## 19. Share capital

**Ordinary share capital represents the total number of shares issued for which dividends accrue.**

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 millions | £m |
|---|---|---|
| At 31 March 2014 and 2015 - ordinary shares of 10p each | | |
| Allotted, called-up and fully paid | 437 | 44 |

In line with the provisions of the Companies Act 2006, during the year ended 31 March 2010, the Company has amended its Articles of Association and ceased to have authorised share capital.

## 20. Net Debt

**Net debt represents the amount of borrowings, overdrafts less cash, financial investments 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

| | 2015 £m | 2014 £m |
|---|---|---|
| Increase/(decrease) in cash and cash equivalents | **9** | (9) |
| Increase/(decrease) in financial investments | **152** | (592) |
| (Increase)/decrease in borrowings and related derivatives | **(487)** | 151 |
| Net interest paid on the components of net debt | **220** | 202 |
| Change in net debt resulting from cash flows | **(106)** | (248) |
| Changes in fair value of financial assets and liabilities and exchange movements | **(123)** | 29 |
| Net interest charge on the components of net debt | **(280)** | (277) |
| Movement in net debt (net of related derivative financial instruments) in the year | **(509)** | (496) |
| Net debt (net of related derivative financial instruments) at start of year | **(6,415)** | (5,919) |
| **Net debt (net of related derivative financial instruments) at end of year** | **(6,924)** | (6,415) |

### Composition of net debt

| | 2015 £m | 2014 £m |
|---|---|---|
| Cash, cash equivalents and financial investments | **481** | 326 |
| Borrowings and bank overdrafts | **(7,123)** | (6,557) |
| Derivatives | **(282)** | (184) |
| **Total net debt** | **(6,924)** | (6,415) |

### (b) Analysis of changes in net debt

| | Cash and cash equivalents £m | Bank overdrafts £m | Total Net cash and cash equivalents £m | Financial investments £m | Borrowings £m | Derivatives £m | Total £m |
|---|---|---|---|---|---|---|---|
| At 1 April 2013 | 3 | - | **3** | 917 | (6,843) | 4 | **(5,919)** |
| Cash flow | (3) | (6) | **(9)** | (594) | 318 | 37 | **(248)** |
| Fair value gains and losses and exchange movements | - | - | **-** | - | 279 | (250) | **29** |
| Interest income/(charges) | - | - | **-** | 3 | (305) | 25 | **(277)** |
| At 31 March 2014 | - | (6) | **(6)** | 326 | (6,551) | (184) | **(6,415)** |
| Cash flow | 3 | 6 | **9** | 142 | (234) | (23) | **(106)** |
| Fair value gains and losses and exchange movements | - | - | **-** | - | (24) | (99) | **(123)** |
| Interest income/(charges) | - | - | **-** | 10 | (314) | 24 | **(280)** |
| **At 31 March 2015** | 3 | - | **3** | 478 | (7,123) | (282) | **(6,924)** |
| **Balances at 31 March 2015 comprise:** | | | | | | | |
| Non-current assets | - | - | **-** | - | - | 402 | **402** |
| Current assets | 3 | - | **3** | 478 | - | 39 | **520** |
| Current liabilities | - | - | **-** | - | (1,611) | (98) | **(1,709)** |
| Non-current liabilities | - | - | **-** | - | (5,512) | (625) | **(6,137)** |
| | 3 | - | **3** | 478 | (7,123) | (282) | **(6,924)** |

# Notes to the consolidated financial statements - supplementary information

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

## 21. Commitments and contingencies

**Commitments are those amounts that we are contractually required to pay in the future as long as the other party meets its obligations. These commitments primarily relate to operating lease rentals 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 that will remain for a specific period.**

| Future capital expenditure | 2015 £m | 2014 £m |
|---|---|---|
| Contracted for but not provided | **1,457** | 1,668 |
| **Operating lease commitments** | | |
| Amounts due: | | |
| Less than 1 year | **12** | 13 |
| In 1 - 2 years | **10** | 9 |
| In 2 - 3 years | **8** | 7 |
| In 3 - 4 years | **6** | 6 |
| In 4 - 5 years | **6** | 6 |
| More than 5 years | **8** | 14 |
| | **50** | 55 |

**Other commitments, contingencies and guarantees**

Guarantees in respect of a former associate amounting to £14m (2014: £14m). These are open ended.

Guarantees in the normal course of business and entered into on normal commercial terms amounted to £1,408m (2014: £903m). These include guarantees of certain obligations for construction of the HVDC West Coast link amounting to £555m (2014: £594m) expiring in 2016.

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.

## 22. 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 plc. The related parties identified include joint ventures, associated undertakings, investments and key management personnel.**

The following material transactions are with fellow subsidiaries of National Grid plc, a joint venture and a pension plan, and are in the normal course of business.

| | Parent | | Other related parties | | Total | |
|---|---|---|---|---|---|---|
| | **2015 £m** | 2014 £m | **2015 £m** | 2014 £m | **2015 £m** | 2014 £m |
| Income: | | | | | | |
| Goods and services supplied (i) | **-** | - | **19** | 21 | **19** | 21 |
| | **-** | - | **19** | 21 | **19** | 21 |
| Expenditure: | | | | | | |
| Services received (ii) | **-** | - | **(107)** | (120) | **(107)** | (120) |
| Corporate services received | **-** | - | **(13)** | (12) | **(13)** | (12) |
| Interest paid on borrowings from fellow subsidiaries | **-** | - | **(9)** | (14) | **(9)** | (14) |
| | **-** | - | **(129)** | (146) | **(129)** | (146) |
| Outstanding balances at 31 March in respect of income, expenditure and settlement of corporation tax: | | | | | | |
| Amounts receivable (iii) | **-** | - | **41** | 19 | **41** | 19 |
| Amounts payable | **-** | - | **(115)** | (78) | **(115)** | (78) |
| Advances to fellow subsidiaries (amounts due within one year): | | | | | | |
| At 1 April | **2** | 2 | **1** | 6 | **3** | 8 |
| Repayments | **(2)** | - | **-** | (5) | **(2)** | (5) |
| At 31 March | **-** | 2 | **1** | 1 | **1** | 3 |
| Borrowings payable to fellow subsidiaries (amounts due within one year): | | | | | | |
| At 1 April | **(10)** | (10) | **(405)** | (12) | **(415)** | (22) |
| Advances | **-** | - | **(1,003)** | (393) | **(1,003)** | (393) |
| Repayments | **10** | - | **43** | - | **53** | - |
| At 31 March | **-** | (10) | **(1,365)** | (405) | **(1,365)** | (415) |
| Borrowings payable to fellow subsidiaries (amounts due after one year): | | | | | | |
| At 1 April | **-** | - | **(305)** | (296) | **(305)** | (296) |
| Advances | **-** | - | **-** | (9) | **-** | (9) |
| Repayments | **-** | - | **305** | - | **305** | - |
| At 31 March | **-** | - | **-** | (305) | **-** | (305) |

(i). Includes £7m in respect of joint ventures (2014: £7m).
(ii). Includes £69m in respect of joint ventures (2014: £69m).
(iii). Includes £1m in respect of joint ventures (2014: £3m).

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

No amounts have been provided at 31 March 2015 (2014: £nil) and no expense recognised during the year (2014: £nil) in respect of bad or doubtful debts for related party transactions.

Details of key management compensation are provided in note 2(d) and information relating to pension fund arrangements is disclosed in notes 17 and 23.

## 23. Actuarial information on pensions

**Further details of the defined benefit scheme terms and the actuarial assumptions used to value the associated assets and obligations are set out in this note.**

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

The National Grid Electricity Group of the Electricity Supply 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 us, the qualified actuary certifies the employer's 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 last full actuarial valuation was carried out as at 31 March 2013. The next valuation is required to be carried out as at 31 March 2016.

The results of the 2013 valuation are shown below:

| | |
|---|---|
| Latest full actuarial valuation | 31 March 2013 |
| Actuary | Aon Hewitt |
| Market value of scheme assets at latest valuation | £1,900m |
| Actuarial value of benefits due to members | £(2,708)m |
| Market value as percentage of benefits | 70% |
| Funding deficit | £808m |
| Funding deficit (net of tax) | £646m |

From April 2014 an annual cap was placed on future increases to the salary used to calculate pensions at the lower of 3% or the annual increase in RPI. This capped salary was applied to all pensionable service from 1 April 2013 onwards. During the year ended 31 March 2014, these changes have resulted in a past service credit of £4m to the income statement (see note 17) and a change to the salary increase assumption which affects how our defined benefit liabilities as at 31 March have been calculated. These changes are to ensure our scheme remains affordable and sustainable over the coming years.

The 2013 actuarial valuation showed that, based on long-term financial assumptions, the contribution rate required to meet future benefit accrual was 33.4% of pensionable earnings (27.5% employers and an average of 5.9% employees). Following the 2013 actuarial valuation, National Grid and the Trustees agreed a recovery plan that will see the funding deficit repaid by 31 March 2027. Under the schedule of contributions a payment of £80m was made in 2013/14 and £46m in 2014/15. Thereafter, annual payments are due of £47m in 2015/16, rising in line with RPI until 2026/27.

As part of the 2013 agreement, National Grid established security arrangements with a charge in favour of the Trustees. At 31 March 2015 the value of this was required to be £150m. This was provided via £150m in a letter of credit. In addition, approximately £36m in UK Government bonds and cash was held. The asstes held as security will be paid to the scheme in the event that National Grid Electricity Transmission plc (NGET) is subject to an insolvency event, or ceases to hold a licence granted under the Electricity Act 1989. The assets held as security will be released back to National Grid if the scheme movies into surplus.

National Grid has also agreed to make a payment in respect of the deficit up to a maximum of £500m should certain triggers be breached; namely if NGET ceases to hold the licence granted under the Electricity Act 1989 or NGET’s credit rating by two out of three specified agencies falls below certain agreed levels for a period of 40 days.

The scheme closed to new members from 1 April 2006.

### Asset allocations

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

| | **2015 Quoted £m** | **2015 Unquoted £m** | **2015 Total £m** | 2014 Quoted £m | 2014 Unquoted £m | 2014 Total £m |
|---|---|---|---|---|---|---|
| Equities | **781** | **153** | **934** | 644 | 149 | 793 |
| Corporate bonds | **221** | **-** | **221** | 281 | - | 281 |
| Government securities | **124** | **-** | **124** | 2 | - | 2 |
| Property | **86** | **89** | **175** | 33 | 79 | 112 |
| Liability matching assets (i) | **946** | **-** | **946** | 598 | - | 598 |
| Other | **46** | **4** | **50** | 174 | (3) | 171 |
| Total | **2,204** | **246** | **2,450** | 1,732 | 225 | 1,957 |

(i). Includes liability-driven investment vehicles.

## 23. Actuarial information on pensions (continued)

### Target asset allocations

The 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 plans as at 31 March 2015 is as follows:

| | % |
|---|---|
| Equities | **42** |
| Other | **58** |
| **Total** | **100** |

### Actuarial assumptions

The Company has applied the following financial assumptions in assessing defined benefit liabilities.

| | 2015 % | 2014 % |
|---|---|---|
| Discount rate[1] | **3.3** | 4.3 |
| Rate of increase in salaries[2] | **3.2** | 3.6 |
| Rate of increase in Retail Price Index[3] | **2.9** | 3.3 |

(i) The discount rate for pension liabilities has been determined by reference to appropriate yields on high quality corporate bonds prevailing in the UK debt markets at the reporting date.

(ii) A promotional scale has also been used where appropriate. The assumption stated is that relating to service prior to 1 April 2014. The assumption for the rate of increase in salaries for service after this date is 2.1%.

(iii) This is the key assumption that determines assumed increases in pensions in payment and deferment. The assumptions were 2.9% (2014: 3.3%) for increases in pensions in payment and 2.1% (2014: 3.3%) for increases in pensions in deferment.

For sensitivity analysis, see note 25.

| | 2015 years | 2014 years |
|---|---|---|
| Assumed life expectations for a retiree at age 65 | | |
| **Today:** | | |
| Males | **24.9** | 25.9 |
| Females | **25.5** | 26.2 |
| **In 20 years:** | | |
| Males | **27.1** | 27.8 |
| Females | **28.2** | 28.5 |

## 24. Financial risk management

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

**This note describes our approach to managing market 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 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
- 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 derivative instruments. The Company's limits are managed by the central treasury department of National Grid, as explained in the 'Principal risks' on pages 22 and 23.

As at 31 March 2014 and 2015, 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.

#### Wholesale and retail credit risk

Our principal commercial exposure is governed by the credit rules within the regulated Connection and Use of System Code. These set out the level of credit relative to the regulatory asset value (RAV) for each credit rating. We have no retail credit risk. Management does not expect any significant losses of receivables.

#### Offsetting financial assets and liabilities

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

## 24. Financial risk management (continued)

### (a) Credit risk (continued)

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

| | | | | Related amounts available to be offset but not offset in statement of financial position | | |
|---|---|---|---|---|---|---|
| As at 31 March 2015 | Gross carrying amounts £m | Gross amounts offset £m | Net amount presented in statement of financial position £m | Financial instruments £m | Cash collateral received/ pledged £m | Net amount £m |
| **Assets** | | | | | | |
| Derivative financial instruments | **441** | **-** | **441** | **(239)** | **(71)** | **131** |
| **Liabilities** | | | | | | |
| Derivative financial instruments | **(723)** | **-** | **(723)** | **239** | **411** | **(73)** |
| **Total** | **(282)** | **-** | **(282)** | **-** | **340** | **58** |

| | | | | Related amounts available to be offset but not offset in statement of financial position | | |
|---|---|---|---|---|---|---|
| As at 31 March 2014 | Gross carrying amounts £m | Gross amounts offset £m | Net amount presented in statement of financial position £m | Financial instruments £m | Cash collateral received/ pledged £m | Net amount £m |
| **Assets** | | | | | | |
| Derivative financial instruments | 269 | - | 269 | (114) | (51) | 104 |
| **Liabilities** | | | | | | |
| Derivative financial instruments | (453) | - | (453) | 114 | 268 | (71) |
| **Total** | (184) | - | (184) | - | 217 | 33 |

## 24. Financial risk management (continued)

### (b) Liquidity analysis

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 21 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 2015** | **Due within 1 year** | **Due between 1 and 2 years** | **Due between 2 and 3 years** | **Due 3 years and beyond** | **Total** |
|---|---|---|---|---|---|
| **Non-derivative financial liabilities** | | | | | |
| Borrowings | **(1,545)** | **(200)** | **(513)** | **(4,624)** | **(6,882)** |
| Interest payments on borrowings (i) | **(176)** | **(175)** | **(170)** | **(2,251)** | **(2,772)** |
| Other non-interest bearing liabilities | **(648)** | **(18)** | **-** | **-** | **(666)** |
| **Derivative financial liabilities** | | | | | |
| Derivative contracts - receipts | **96** | **93** | **234** | **247** | **670** |
| Derivative contracts - payments | **(134)** | **(85)** | **(344)** | **(606)** | **(1,169)** |
| **Total at 31 March 2015** | **(2,407)** | **(385)** | **(793)** | **(7,234)** | **(10,819)** |

| At 31 March 2014 | Due within 1 year | Due between 1 and 2 years | Due between 2 and 3 years | Due 3 years and beyond | Total |
|---|---|---|---|---|---|
| **Non-derivative financial liabilities** | | | | | |
| Borrowings | (468) | (116) | (200) | (5,616) | (6,400) |
| Interest payments on borrowings (i) | (194) | (196) | (199) | (2,697) | (3,286) |
| Other non-interest bearing liabilities | (638) | (15) | - | - | (653) |
| **Derivative financial liabilities** | | | | | |
| Derivative contracts - receipts | 109 | 57 | 49 | 312 | 527 |
| Derivative contracts - payments | (77) | (42) | (62) | (835) | (1,016) |
| Total at 31 March 2014 | (1,268) | (312) | (412) | (8,836) | (10,828) |

(i). 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.

### (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 14 (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 2015 and 2014, net debt was managed using derivative instruments to hedge interest rate risk as follows:

| | **2015** | | | | |
|---|---|---|---|---|---|
| | **Fixed rate £m** | **Floating rate £m** | **RPI £m** | **Other (i) £m** | **Total £m** |
| Cash | **-** | **3** | **-** | **-** | **3** |
| Financial investments | **34** | **444** | **-** | **-** | **478** |
| Borrowings | **(2,716)** | **(1,750)** | **(2,657)** | **-** | **(7,123)** |
| **Pre-derivative position** | **(2,682)** | **(1,303)** | **(2,657)** | **-** | **(6,642)** |
| Derivative effect | **727** | **(965)** | **(44)** | **-** | **(282)** |
| **Net debt position (ii)** | **(1,955)** | **(2,268)** | **(2,701)** | **-** | **(6,924)** |

## 24. Financial risk management (continued)

### (c) Interest rate risk (continued)

| | 2014 | | | | |
|---|---|---|---|---|---|
| | Fixed rate £m | Floating rate £m | RPI £m | Other (i) £m | Total £m |
| Financial investments | 35 | 290 | - | 1 | 326 |
| Borrowings | (2,847) | (780) | (2,925) | (5) | (6,557) |
| Pre-derivative position | (2,812) | (490) | (2,925) | (4) | (6,231) |
| Derivative effect | 1,244 | (1,467) | 39 | - | (184) |
| Net debt position (ii) | (1,568) | (1,957) | (2,886) | (4) | (6,415) |

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

(ii). The impact of 2015/16 (2014: 2014/15) maturing short-dated interest rate derivatives is included.

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

During 2015 and 2014, derivative financial instruments were used to manage foreign currency risk as follows:

| | **2015** | | | |
|---|---|---|---|---|
| | **Sterling £m** | **Euro £m** | **Other £m** | **Total £m** |
| Cash | **3** | **-** | **-** | **3** |
| Financial investments | **478** | **-** | **-** | **478** |
| Borrowings | **(5,840)** | **(240)** | **(1,043)** | **(7,123)** |
| **Pre-derivative position** | **(5,359)** | **(240)** | **(1,043)** | **(6,642)** |
| Derivative effect | **(1,972)** | **630** | **1,060** | **(282)** |
| **Net debt position** | **(7,331)** | **390** | **17** | **(6,924)** |

| | 2014 | | | |
|---|---|---|---|---|
| | Sterling £m | Euro £m | Other £m | Total £m |
| Cash | - | - | - | - |
| Financial investments | 326 | - | - | 326 |
| Borrowings | (5,243) | (253) | (1,061) | (6,557) |
| Pre-derivative position | (4,917) | (253) | (1,061) | (6,231) |
| Derivative effect | (1,996) | 721 | 1,091 | (184) |
| Net debt position | (6,913) | 468 | 30 | (6,415) |

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

### (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 20). 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, and indicates the level of debt employed to fund our regulated business. The RAV gearing ratio at 31 March 2015 was 61% compared with 59% at 31 March 2014. We regularly review and maintain or adjust the capital structure as appropriate in order to manage the level of RAV gearing. It is compared with the level of RAV gearing indicated by Ofgem as being appropriate for our business, at around 60%.

## 24. Financial risk management (continued)

**(f) Fair value analysis**

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

| | **2015** | | | | 2014 | | | |
|---|---|---|---|---|---|---|---|---|
| | **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 | **34** | **-** | **-** | **34** | 34 | - | - | 34 |
| Derivative financial instruments | **-** | **427** | **14** | **441** | - | 249 | 20 | 269 |
| | **34** | **427** | **14** | **475** | 34 | 249 | 20 | 303 |
| **Liabilities** | | | | | | | | |
| Derivative financial instruments | **-** | **(611)** | **(112)** | **(723)** | - | (380) | (73) | (453) |
| **Total** | **34** | **(184)** | **(98)** | **(248)** | 34 | (131) | (53) | (150) |

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

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

| | **2015 Level 3 valuation £m** | 2014 Level 3 valuation £m |
|---|---|---|
| **At 1 April** | **(53)** | (47) |
| Net gains/(losses) for the year (i) | **(43)** | (3) |
| Settlements | **(2)** | (3) |
| **At 31 March** | **(98)** | (53) |

(i). Losses of £43m (2014: £3m losses) are attributable to assets or liabilities held at the end of the reporting period and have been recognised in finance costs in the income statement.

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

| | **2015 Income Statement £m** | 2014 Income Statement £m |
|---|---|---|
| +20 basis point change in LPI market curve (i) | **(48)** | (33) |
| -20 basis point change in LPI market curve (i) | **46** | 32 |

(i). 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.

## 25. Sensitivities on areas of estimation and uncertainty

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

The sensitivities in the table below show the potential impact in the income statement (and consequential impact on net assets) for a range of different variables which each have been considered in isolation (ie with all other variables remaining constant). There are a number of these sensitivities which are mutually exclusive and therefore if one were to happen, another would not, meaning a total showing how sensitive our results are to these external factors is not meaningful.
We are further required to show additional sensitivity analysis for changes in interest and exchange rates and these are shown separately in the table below due to the additional assumptions that are made in order to produce meaningful sensitivity disclosures.
The sensitivities included in the table below all have an equal and opposite effect if the sensitivity increases or decreases by the same amount unless otherwise stated. For example a 10% increase in unbilled revenue at 31 March 2015 would result in a decrease in the income statement of £16 million and a 10% decrease in unbilled revenue would have the equal but opposite effect.

| | **2015** | | 2014 | |
|---|---|---|---|---|
| | **Income Statement £m** | **Net Assets £m** | Income Statement £m | Net Assets £m |
| **One year average change in economic useful lives (pre-tax)** | | | | |
| Depreciation charge on property, plant and equipment | **9** | **9** | 8 | 8 |
| Amortisation charge on intangible assets | **1** | **1** | 1 | 1 |
| Estimated future cash flows in respect of provisions change of 10% (pre-tax) | **9** | **9** | 11 | 11 |
| **Assets and liabilities carried at fair value change of 10% (pre-tax)** | | | | |
| Derivative financial instruments (i) | **(28)** | **(28)** | (18) | (18) |
| **Pensions obligations benefit (pre-tax) (ii)** | | | | |
| Discount rate change of 0.5% (iii) | **4** | **252** | 5 | 200 |
| RPI rate change of 0.5% (iv) | **3** | **237** | 4 | 198 |
| Change in long-term rate of increase in salaries change of 0.5% (v) | **-** | **37** | 2 | 33 |
| Change of one year to life expectancy at age 65 | **-** | **84** | 1 | 67 |
| Unbilled revenue at 31 March change of 10% (post-tax) | **16** | **16** | 16 | 16 |
| No hedge accounting for our derivative financial instruments (post-tax) | **5** | **73** | (46) | (54) |

(i) The effect of a 10% change in fair value assumes no hedge accounting.

(ii) The changes shown are a change in the annual pension service charge and change in the defined benefit obligations.

(iii) 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 scheme.

(iv) 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.

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

| | **Income Statement £m** | **Other equity reserves £m** | Income Statement £m | Other equity reserves £m |
|---|---|---|---|---|
| **Financial risk[6] (post-tax)** | | | | |
| RPI change of 0.5% (i) | **10** | **-** | 11 | - |
| Interest rates change of 0.5% | **10** | **36** | 7 | 17 |

(i) Excludes sensititives to LPI index. Further details on sensitivities are provided in note 24(f).

### Pensions benefits assumptions

Sensitivities have been prepared to show how the defined benefit obligations and annual service costs could potentially be impacted by changes in the relevant actuarial assumptions that were reasonably possible as at 31 March 2015. 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 where the corresponding change to increases to pensions in payment, increases to pensions in deferment and resultant increases in salary is recognised.

### Financial instruments assumptions

Our financial instruments are sensitive to changes in market variables, being UK interest rates, the UK RPI and the dollar 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.

## 25. Sensitivities on areas of estimation and uncertainty (continued)

**Financial instruments assumptions (continued)**

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

- the amount of net debt, the ratio of fixed to floating interest rates of the debt and derivatives portfolio, and the proportion of financial instruments in foreign currencies are all constant and on the basis of the hedge designations in place at 31 March 2015 and 2014 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. Ultimate parent company

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

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

## 27. Subsidiary undertakings, and joint ventures

**While we present consolidated results in these financial statements as if we were one company, our structure is such that there are a number of subsidiaries and joint ventures that contribute to the overall result.**

**Subsidiary undertakings**

The list below contains all subsidiaries included within the National Grid Electricity Transmission plc Group.

| | Principal activity | Holding |
|---|---|---|
| Elexon Limited | Electricity market Balance and Settlement Code company for Great Britain | 100% (i) |
| NGC Employees Shares Trustee Limited | Trustee of the NGC profit sharing scheme and NGC Employee Trust | 100% |
| National Grid Electricity Group Trustee Limited | Pension nominee company | 100% |
| NG Leasing Limited | In liquidation | 100% |

(i) National Grid Electricity Transmission does not consolidate its wholly owned subsidiary Elexon Limited, as it has no control over Elexon.

All subsidiaries are incorporated in England and Wales.

**Joint ventures**

The list below contains all joint ventures included within the National Grid Electricity Transmission plc Group.

| | Principal activity | Holding |
|---|---|---|
| NGET/SPT Upgrades Limited | Construction services for the England-Scotland interconnector | 50% |
| Coreso SA (incorporated in Belgium) | Joint venture in relation to a European regional transmission operations coordination centre | 22.485% |

# Company accounting policies

**for the year ended 31 March 2015**

We are required to include the stand-alone balance sheet of our ultimate parent Company, National Grid Electricity Transmission plc, under the Companies Act 2006 and the following disclosures provide additional information to stakeholders.

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

These individual financial statements of the Company have been prepared in accordance with applicable UK accounting and financial reporting standards and the Companies Act 2006. They have been prepared on an historical cost basis, except for the revaluation of financial instruments, and are presented in pounds sterling, which is the currency of the primary economic environment in which the Company operates. The 2014 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 29.

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 the exemption from preparing a cash flow statement under the terms of FRS 1 (revised 1996) 'Cash Flow Statements'.

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

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

## B. 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.

## C. 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.

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, extensions to, or significant increases in, the capacity of tangible fixed assets.

Contributions received towards the cost of tangible fixed assets are included in creditors as deferred income and credited on a straight-line basis to the profit and loss account over the life of the assets.

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.

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 table below:

| **Depreciation periods** | Years |
|---|---|
| Freehold and leasehold buildings | up to 50 |
| Plant and Machinery | |
| - Electricity Transmission plant | 15 to 60 |
| Motor vehicles and office equipment | up to 7 |

## D. 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.

## E. 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.

## F. 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.

## G. Stocks

Stocks are stated at cost less provision for deterioration and obsolescence.

## H. 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.

## I. Revenue

Revenue represents the sales value derived from the transmission of electricity and the provision of related services during the year, including an assessment of services provided but not invoiced as at the year end and excludes value added tax and intra-group sales.

The sales value for the transmission of electricity is largely determined from the amount of electricity transmitted in the year and system capacity sold for the year, evaluated at contractually determined prices or recovery rates. The sales value for the provision of balancing services is based on the amount of system balancing costs incurred.
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.

Income arising from the sale of properties as a result of our property management activities is reported as other operating income.

## J. Pensions

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 on retirement benefit scheme liabilities and the expected return on scheme assets during the year are recognised in the profit and loss account within net interest.

The actuarial value of pension liabilities, net of the market value of the assets of the scheme are recognised as a liability in the balance sheet, net of the related deferred tax asset.

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 recognised directly in equity within the profit and loss account reserve.

## K. Leases

Operating lease payments are charged to the profit and loss account on a straight-line basis over the term of the lease.

## L. Financial instruments

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

The policies are set out in notes 9, 10, 12, 13, 14 and 15 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.

## M. 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 10 to the consolidated financial statements.

## N. 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.

## O. Restructuring costs

Costs arising from the Company's restructuring programmes primarily relate to redundancy costs. Redundancy costs are charged to the profit and loss account in the period in which the Company becomes irrevocably committed to incurring the costs and the main features of the restructuring plan have been announced to affected employees.

## P. Dividends

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

# Company balance sheet

**as at 31 March**

| | Notes | 2015 £m | 2014 £m |
|---|---|---|---|
| **Fixed assets** | | | |
| Tangible assets | 4 | **11,311** | 10,673 |
| | | **11,311** | 10,673 |
| **Current assets** | | | |
| Stocks | 5 | **30** | 29 |
| Debtors | 6 | **275** | 244 |
| Derivative financial instruments (amounts falling due within one year) | 7 | **39** | 21 |
| Derivative financial instruments (amounts falling due after more than one year) | 7 | **402** | 248 |
| Investments | 8 | **478** | 326 |
| Cash at bank and in hand | | **3** | - |
| | | **1,227** | 868 |
| **Creditors (amounts falling due within one year)** | | | |
| Borrowings | 11 | **(1,611)** | (532) |
| Derivative financial instruments | 7 | **(98)** | (62) |
| Other creditors | | **(984)** | (882) |
| | 9 | **(2,693)** | (1,476) |
| **Net current liabilities** | | **(1,466)** | (608) |
| **Total assets less current liabilities** | | **9,845** | 10,065 |
| **Creditors (amounts falling due after more than one year)** | | | |
| Borrowings | 11 | **(5,512)** | (6,025) |
| Derivative financial instruments | 7 | **(625)** | (391) |
| Other creditors | | **(348)** | (330) |
| | 10 | **(6,485)** | (6,746) |
| **Provisions for liabilities** | 12 | **(951)** | (934) |
| **Net assets before pension liability** | | **2,409** | 2,385 |
| Net pension liability | 13 | **(313)** | (394) |
| **Net assets** | | **2,096** | 1,991 |
| **Capital and reserves** | | | |
| Called up share capital | 14 | **44** | 44 |
| Cash flow hedge reserve | 15 | **(89)** | (23) |
| Profit and loss account | 15 | **2,141** | 1,970 |
| **Total shareholders' funds** | 16 | **2,096** | 1,991 |

The notes on pages 79 to 84 form part of the individual financial statements of the Company, which were approved by the Board of Directors and authorised for issue on 1 July 2015. and were signed on its behalf by:

**Mark Ripley** Director

**Andy Agg** Director

**National Grid Electricity Transmission plc**
Registered number: 2366977

# Notes to the Company financial statements

## 1. Auditors' remuneration

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

| | **2015 £m** | 2014 £m |
|---|---|---|
| Audit services | | |
| Audit fee of parent company and consolidated financial statements | **0.2** | 0.2 |
| Other services | | |
| Fees payable to the Company's auditors for audit related assurance services | **0.3** | 0.1 |

Fees payable to the Company's auditors for audit related assurance services represents fees payable for services in relation to engagements which are required to be carried out by the auditors. In particular this includes fees for audit reports on regulatory returns.

## 2. Number of employees, including Directors

| | **2015 Monthly Average number** | 2014 Monthly Average number (i) |
|---|---|---|
| UK | **3,273** | 3,384 |

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

## 3. Directors' emoluments

Details of Directors' emoluments are provided in note 2(d) to the consolidated financial statements.

## 4. Tangible fixed 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 2014 | 490 | 11,040 | 2,886 | 325 | 14,741 |
| Additions | 3 | 63 | 957 | 49 | 1,072 |
| Disposals | - | (19) | (1) | (2) | (22) |
| Reclassifications | 62 | 502 | (556) | (8) | - |
| Other movements (i) | - | (57) | - | - | (57) |
| Cost at 31 March 2015 | 555 | 11,529 | 3,286 | 364 | 15,734 |
| Depreciation at 1 April 2014 | (75) | (3,801) | - | (192) | (4,068) |
| Depreciation charge for the year | (15) | (330) | - | (30) | (375) |
| Disposals | - | 18 | - | 2 | 20 |
| Reclassifications | (2) | 2 | - | - | - |
| Depreciation at 31 March 2015 | (92) | (4,111) | - | (220) | (4,423) |
| **Net book value at 31 March 2015** | **463** | **7,418** | **3,286** | **144** | **11,311** |
| Net book value at 31 March 2014 | 415 | 7,239 | 2,886 | 133 | 10,673 |

(i). Credit relating to settlement of legal claims relating to equipment procurement (see note 3 to the consolidated financial statements).

The net book value of land and buildings comprised:

| | **2015 £m** | 2014 £m |
|---|---|---|
| Freehold | **384** | 330 |
| Long leasehold (over 50 years) | **7** | 2 |
| Short leasehold (under 50 years) | **72** | 83 |
| | **463** | 415 |

The cost of tangible fixed assets at 31 March 2015 included £1,134m (2014: £1,040m) relating to interest capitalised.

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 £7m (2014: £7m) and £308m (2014: £295m) respectively.

## 5. Stocks

| | 2015 £m | 2014 £m |
|---|---|---|
| Raw materials, spares and consumables | **30** | 29 |

## 6. Debtors

| | 2015 £m | 2014 £m |
|---|---|---|
| Amounts falling due within one year: | | |
| Trade debtors | **47** | 26 |
| Amounts owed by fellow subsidiary undertakings | **40** | 16 |
| Other debtors | **10** | 9 |
| Prepayments and accrued income | **178** | 193 |
| | **275** | 244 |

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

## 7. Derivative financial instruments

The fair value of derivative financial instruments shown on the balance sheet is as follows:

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | **Assets** | **Liabilities** | **Total** | Assets | Liabilities | Total |
| Amounts falling due in one year | **39** | **(98)** | **(59)** | 21 | (62) | (41) |
| Amounts falling due after more than one year | **402** | **(625)** | **(223)** | 248 | (391) | (143) |
| | **441** | **(723)** | **(282)** | 269 | (453) | (184) |

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

| | 2015 £m | 2014 £m |
|---|---|---|
| Interest rate swaps | **(3,731)** | (3,804) |
| Cross-currency interest rate swaps | **(1,336)** | (1,336) |
| Foreign exchange forward currency | **(449)** | (533) |
| Inflation linked swaps | **(622)** | (630) |
| | **(6,138)** | (6,303) |

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

## 8. Investments

| | 2015 £m | 2014 £m |
|---|---|---|
| Loans and receivables - amounts due from fellow subsidiaries | **1** | 3 |
| Loans and receivables - restricted cash balances (i) | **443** | 289 |
| Available-for-sale investments (ii) | **34** | 34 |
| | **478** | 326 |

Investments also include investment in subsidiaries totalling £0.3m (2014: £0.4m). The names of the subsidiary undertakings are included in note 27 to the consolidated financial statements.

(i). Comprises collateral placed with counterparties with whom we have entered into a credit support annex to the ISDA Master Agreement £442m (2014: £288m) and secured bank accounts with charges in favour of the UK pension schemes Trustees of £1m (2014: £1m).

(ii). Refers to assets held within security accounts with charges in favour of the UK pension scheme Trustees of £nil (2014: £34m).

## 9. Creditors (amounts falling due within one year)

| | 2015 £m | 2014 £m |
|---|---|---|
| Borrowings (note 11) | **1,611** | 532 |
| Derivative financial instruments (note 7) | **98** | 62 |
| Trade creditors | **461** | 451 |
| Amounts owed to fellow subsidiary undertakings | **120** | 82 |
| Social security and other taxes | **104** | 52 |
| Other creditors | **44** | 30 |
| Accruals and deferred income | **255** | 267 |
| | **2,693** | 1,476 |

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

## 10. Creditors (amounts falling due after more than one year)

| | 2015 £m | 2014 £m |
|---|---|---|
| Borrowings (note 11) | **5,512** | 6,025 |
| Derivative financial instruments (note 7) | **625** | 391 |
| Other creditors | **18** | 15 |
| Deferred income | **330** | 315 |
| | **6,485** | 6,746 |

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

Deferred income mainly comprises contributions to capital projects.

## 11. Borrowings

The following table analyses the company's total borrowings:

| | **2015** **£m** | 2014 £m |
|---|---|---|
| Amounts falling due within one year: | | |
| Bank overdrafts | **-** | 6 |
| Bank loans | **71** | 51 |
| Bonds | **175** | 60 |
| Borrowings from fellow subsidiary undertakings | **1,365** | 415 |
| | **1,611** | 532 |
| Amounts falling due after more than one year | | |
| Bank loans | **412** | 410 |
| Bonds | **5,100** | 5,310 |
| Borrowings from fellow subsidiary undertakings | **-** | 305 |
| | **5,512** | 6,025 |
| **Total borrowings** | **7,123** | 6,557 |

| | **2015** **£m** | 2014 £m |
|---|---|---|
| Total borrowings are repayable as follows: | | |
| Less than 1 year | **1,611** | 532 |
| In 1 - 2 years | **200** | 127 |
| In 2 - 3 years | **516** | 200 |
| In 3 - 4 years | **515** | 524 |
| In 4 - 5 years | **218** | 516 |
| More than 5 years other than by instalments | **4,063** | 4,658 |
| | **7,123** | 6,557 |

The notional amount outstanding of the Company's debt portfolio at 31 March 2015 was £6,882m (2014: £6,400m).

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

## 12. Provisions for liabilities

| | Deferred tax £m | Environ-mental £m | Other £m | Total £m |
|---|---|---|---|---|
| At 1 April 2014 | 822 | 74 | 38 | 934 |
| Charged/(credited) to profit and loss account | 52 | (4) | - | 48 |
| Transferred to reserves | (16) | - | - | (16) |
| Unwinding of discount | - | 3 | - | 3 |
| Utilised | - | (1) | (17) | (18) |
| **At 31 March 2015** | **858** | **72** | **21** | **951** |

Details of the environmental provision and other provisions are shown in note 18 to the consolidated financial statements.

**Deferred tax**

Deferred tax provided in the financial statements comprises:

| | **2015** **£m** | 2014 £m |
|---|---|---|
| Accelerated capital allowances | **885** | 835 |
| Other timing differences, excluding pensions liability | **(27)** | (13) |
| Included within provisions for liabilities and charges | **858** | 822 |
| Pensions liability | **(78)** | (99) |
| | **780** | 723 |

At 31 March 2015 there are no material unrecognised deferred tax assets (2014: £nil).

## 13. Pensions

National Grid Electricity Transmission's employees are members of either the National Grid Electricity Group of the Electricity Supply Pension Scheme (the Scheme) which is a defined benefit pension scheme and The National Grid YouPlan which is a defined contribution trust. Further details of the Scheme and the actuarial assumptions used to value the associated assets and pension obligations are provided in notes 17 and 23 to the consolidated financial statements.

**Amounts recognised in the balance sheet of the Company are as follows:**

| | 2015 £m | 2014 £m |
|---|---|---|
| Present value of funded obligations | **(2,798)** | (2,416) |
| Fair value of plan assets | **2,450** | 1,957 |
| | **(348)** | (459) |
| Present value of unfunded obligations | **(43)** | (34) |
| Net liability in the balance sheet | **(391)** | (493) |
| Related deferred tax asset | **78** | 99 |
| Net pension liability | **(313)** | (394) |

| | 2015 £m | 2014 £m |
|---|---|---|
| **Changes in the present value of defined benefit obligations (including unfunded obligations)** | | |
| Opening defined benefit obligations | **2,450** | 2,542 |
| Current service cost | **23** | 36 |
| Interest cost | **103** | 107 |
| Actuarial losses/(gains) | **368** | (142) |
| Net increase in liabilities from redundancies | **11** | 16 |
| Employee contributions | **1** | 1 |
| Benefits paid | **(115)** | (110) |
| Closing defined benefit obligations | **2,841** | 2,450 |

| | 2015 £m | 2014 £m |
|---|---|---|
| **Changes in the fair value of scheme assets** | | |
| Opening fair value of plan assets | **1,957** | 1,943 |
| Expected return on plan assets | **99** | 99 |
| Actuarial gains/(losses) | **417** | (65) |
| Employer contributions | **91** | 89 |
| Employee contributions | **1** | 1 |
| Benefits paid | **(115)** | (110) |
| Closing fair value of scheme assets | **2,450** | 1,957 |

## 14. Called-up share capital

| | Number of shares 2015 millions | Number of shares 2014 millions | 2015 £m | 2014 £m |
|---|---|---|---|---|
| At 31 March 2014 and 2015 - ordinary shares of 10p each<br>Allotted, called-up and fully paid | **437** | 437 | **44** | 44 |

## 15. Reserves

| | Cash flow hedge reserve £m | Profit and loss account £m |
|---|---|---|
| At 1 April 2014 | (23) | 1,970 |
| Actuarial gains (net of tax) | - | 40 |
| Net gain transferred to equity in respect of cash flow hedges (net of tax) | (66) | - |
| Share-based payments | - | 4 |
| Profit for the financial year | - | 782 |
| Dividends | - | (655) |
| **At 31 March 2015** | **(89)** | **2,141** |

The Company has not presented its own profit and loss account as permitted by section 408 of the Companies Act 2006. The Company's profit for the financial year was £782m (2014: £774m).

## 16. Reconciliation of movement in shareholders' funds

| | 2015 £m | 2014 £m |
|---|---|---|
| Profit for the year after tax | **782** | 774 |
| Dividends (i) | **(655)** | (300) |
| Profit for the financial year | **127** | 474 |
| Net (losses)/gains recognised directly in reserves | **(26)** | 60 |
| Share-based payments | **4** | 2 |
| Net increase in shareholders' funds | **105** | 536 |
| Opening shareholders' funds | **1,991** | 1,455 |
| **Closing shareholders' funds** | **2,096** | 1,991 |

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

## 17. Commitments and contingencies

**(a) Future capital expenditure**

| | 2015 £m | 2014 £m |
|---|---|---|
| Contracted for but not provided | **1,457** | 1,668 |

**(b) Lease commitments**

At 31 March 2015, the Company's total operating lease commitments for the financial year ending 31 March 2016 amounted to £12m (2014 commitments for 2015: £13m) and are analysed by lease expiry date as follows:

| | Land and buildings | | Other | | Total | |
|---|---|---|---|---|---|---|
| | 2015 £m | 2014 £m | 2015 £m | 2014 £m | 2015 £m | 2014 £m |
| Expiring: | | | | | | |
| In one year or less | **-** | - | **1** | 2 | **1** | 2 |
| In more than one year, but not more than five years | **1** | 2 | **4** | 3 | **5** | 5 |
| In more than five years | **6** | 6 | **-** | - | **6** | 6 |
| | **7** | 8 | **5** | 5 | **12** | 13 |

**(c) Other commitments, contingencies and guarantees**

Guarantees in respect of a former associate amounting to £14m (2014: £14m). These are open ended.

Guarantees in the normal course of business and entered into on normal commercial terms amounted to £1,408m (2014: £903m). These include guarantees of certain obligations for construction of the HVDC West Coast link amounting to £555m (2014: £594m) expiring in 2016.

# Glossary and definitions

References to the 'Company', 'we', 'our' and 'us' refer to National Grid Electricity Transmission plc itself or to National Grid Electricity Transmission plc and its subsidiaries collectively, depending on context.

**BSIS**
The Balancing Services Incentive Scheme, an incentive arrangement applicable to the Company's electricity transmission arrangements.

**Delivery Body**
Under the Energy Act 2013, and secondary legislation which came into force in August 2014, National Grid Electricity Transmission's system operator function became the EMR Delivery Body. In this role National Grid Electricity Transmission provides independent evidence and analysis to the UK Government to inform its decisions on the key rules and parameters to achieve the Government's policy objectives under EMR. National Grid Electricity Transmission also administers the capacity mechanism, including running the annual capacity auctions, manages the allocation of contracts for difference to low carbon generators and reports to the Government annually on performance against the Government's delivery plan.

**Electricity Market Reform (EMR)**
An energy policy initiative, introduced by the Energy Act 2013, designed to provide greater financial certainty to investors in both low carbon and conventional generation in order to meet environmental targets and maintain security of supply, and to do so at the lowest cost to consumers.

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

**IFRS**
International Financial Reporting Standard.

**KPI**
Key Performance Indicator.

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

**National Grid**
National Grid plc, the ultimate parent company of National Grid Electricity Transmission plc and its controlling party.

**Ofgem**
The Office of Gas and Electricity Markets.

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

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

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

**RoE**
A performance metric measuring returns from the investment of shareholders' funds. 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 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

**tonnes $CO_2$ equivalent**
Measure of greenhouse gas emissions in relation to the impact of carbon dioxide.

**TW**
Terawatt, $10^{12}$ watts.

**TWh**
Terawatt hours.

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