nationalgrid

Nantucket Electric Company

Financial Statements

For the years ended March 31, 2014 and 2013

NANTUCKET ELECTRIC COMPANY

TABLE OF CONTENTS

Independent Auditor's Report

To the Shareholder and Board of Directors
of Nantucket Electric Company

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

Opinion

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

PricewaterhouseCoopers LLP

September 7, 2014

NANTUCKET ELECTRIC COMPANY
STATEMENTS OF INCOME
(in thousands of dollars)

	Years Ended March 31,	
	2014	2013
Operating revenues	**$ 28,271**	$ 22,648
Operating expenses:		
Purchased electricity	**10,048**	7,837
Operations and maintenance	**9,247**	7,212
Depreciation and amortization	**3,723**	3,648
Other expenses	**792**	672
Total operating expenses	**23,810**	19,369
Operating income	**4,461**	3,279
Other income and (deductions):		
Interest on long-term debt	**(445)**	(500)
Other interest, including affiliate interest	**(96)**	(81)
Other income, net	**381**	131
Total other deductions, net	**(160)**	(450)
Income before income taxes	**4,301**	2,829
Income tax expense	**1,777**	549
Net income	**$ 2,524**	$ 2,280

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

NANTUCKET ELECTRIC COMPANY
STATEMENTS OF COMPREHENSIVE INCOME
(in thousands of dollars)

	Years Ended March 31,	
	2014	**2013**
Net income	**$ 2,524**	$ 2,280
Other comprehensive income:		
Unrealized gains on securities, net of $29 and $23 tax expense	**43**	34
Change in pension and other postretirement obligations, net of $0 and $72 tax expense	**-**	113
Reclassification of gains into net income, net of $24 and $11 tax expense	**(36)**	(17)
Total other comprehensive income	**7**	130
Comprehensive income	**$ 2,531**	$ 2,410

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

NANTUCKET ELECTRIC COMPANY
STATEMENTS OF CASH FLOWS
(in thousands of dollars)

	Years Ended March 31,	
	2014	2013
Operating activities:		
Net income	**$ 2,524**	2,280
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**3,723**	3,648
Provision for deferred income taxes	**(813)**	551
Bad debt expense	**123**	65
Amortization of debt issuance costs	**746**	445
Net postretirement benefits (contributions) expense	**337**	40
Changes in operating assets and liabilities:		
Accounts receivable, net, and unbilled revenues	**(693)**	(474)
Accounts receivable from/payable to affiliates, net	**-**	(746)
Inventory	**48**	(18)
Regulatory assets and liabilities, net	**2,289**	2,079
Prepaid and accrued taxes	**1,220**	674
Accounts payable and other liabilities	**273**	(850)
Other, net	**(56)**	(215)
Net cash provided by operating activities	**9,721**	**7,479**
Investing activities:		
Capital expenditures	**(2,954)**	(3,392)
Affiliated money pool investing and receivables/payables, net	**(25,899)**	(3,080)
Cost of removal and other	**(270)**	(241)
Net cash used in investing activities	**(29,123)**	**(6,713)**
Financing activities:		
Payments on long-term debt	**(305)**	(275)
Advance from affiliate	**20,000**	-
Parent loss tax allocation	**356**	(278)
Net cash provided by (used in) financing activities	**20,051**	**(553)**
Net increase in cash and cash equivalents	**649**	213
Cash and cash equivalents, beginning of year	**354**	141
Cash and cash equivalents, end of year	**$ 1,003**	354
Supplemental disclosures:		
Interest paid	$ (105)	$ (353)
Income taxes paid	(938)	(615)

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

NANTUCKET ELECTRIC COMPANY
BALANCE SHEETS
(in thousands of dollars)

	March 31, 2014	March 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 1,003**	$ 354
Special deposits	**47**	46
Accounts receivable	**1,859**	1,379
Allowance for doubtful accounts	**(156)**	(80)
Unbilled revenues	**1,203**	1,037
Accounts receivable from affiliates	**449**	1,774
Intercompany money pool	**60,798**	25,810
Inventory	**129**	177
Regulatory assets	**4,800**	5,440
Current portion of deferred income tax assets	**4,860**	3,949
Other	**44**	6
Total current assets	**75,036**	39,892
Property, plant, and equipment, net	**69,541**	70,006
Other non-current assets		
Regulatory assets	**4,698**	4,197
Goodwill	**15,706**	15,706
Financial investments	**829**	758
Other	**1,031**	1,083
Total other non-current assets	**22,264**	21,744
Total assets	**$ 166,841**	$ 131,642

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

NANTUCKET ELECTRIC COMPANY
BALANCE SHEETS
(in thousands of dollars)

	March 31, 2014	March 31, 2013
LIABILITIES AND CAPITALIZATION		
Current liabilities:		
Accounts payable	**$ 1,003**	933
Accounts payable to affiliates	**9,411**	1,647
Advance from affiliate	**20,000**	-
Current portion of long-term debt	**330**	305
Taxes and interest accrued	**3,265**	2,011
Regulatory liabilities	**16,876**	15,318
Other	**445**	419
Total current liabilities	**51,330**	20,633
Other non-current liabilities		
Regulatory liabilities	**2,166**	1,578
Deferred income tax liabilities	**14,253**	13,843
Postretirement benefits	**5,071**	4,449
Other	**709**	384
Total other non-current liabilities	**22,199**	20,254
Commitments and contingencies (Note 10)		
Capitalization:		
Shareholder's equity	**41,647**	38,760
Long-term debt	**51,665**	51,995
Total capitalization	**93,312**	90,755
Total liabilities and capitalization	**$ 166,841**	$ 131,642

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

NANTUCKET ELECTRIC COMPANY
STATEMENTS OF CAPITALIZATION
(in thousands of dollars)

			March 31,	
			2014	2013
Total shareholder's equity			**$ 41,647**	$ 38,760
Long-term debt:	Interest Rate	Maturity Date		
Unsecured notes:				
2016 Series 1996 MIFA Tax exempt	Variable	March 1, 2016	**695**	1,000
2004 $10 Million MIFA Tax exempt	Variable	March 1, 2039	**10,000**	10,000
2005 $28 Million MIFA Tax exempt	Variable	December 1, 2040	**28,000**	28,000
2007 $13.3 Million1996 MDFA Tax exempt	Variable	August 1, 2042	**13,300**	13,300
Total long-term debt			**51,995**	52,300
Current portion of long-term debt			**330**	305
Long-term debt			**51,665**	51,995
Total capitalization			**$ 93,312**	$ 90,755

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

NANTUCKET ELECTRIC COMPANY
STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY
(in thousands of dollars, except per share and number of shares data)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss): Unrealized Gain (Loss) on Available for Sale Securities	Accumulated Other Comprehensive Income (Loss): Pension and Postretirement Benefits	Accumulated Other Comprehensive Income (Loss): Total Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
Balance as of March 31, 2012	**$ -**	**$ 23,117**	**$ 49**	**$ (113)**	**$ (64)**	**$ 13,575**	**$ 36,628**
Net income	-	-	-	-	-	2,280	2,280
Other comprehensive income (loss):							
Unrealized gains on securities, net of $23 tax expense	-	-	34	-	34	-	34
Changes in pension and other postretirement obligations, net of $72 tax expense	-	-	-	113	113	-	113
Reclassification adjustment for gains included in net income, net of $11 tax expense	-	-	(17)	-	(17)	-	(17)
Total comprehensive income							2,410
Parent tax loss allocation	-	(278)	-	-	-	-	(278)
Balance as of March 31, 2013	**$ -**	**$ 22,839**	**$ 66**	**$ -**	**$ 66**	**$ 15,855**	**$ 38,760**
Net income	-	-	-	-	-	2,524	2,524
Other comprehensive income (loss):							
Unrealized gains on securities, net of $29 tax expense	-	-	43	-	43	-	43
Reclassification adjustment for gains included in net income, net of $24 tax expense	-	-	(36)	-	(36)	-	(36)
Total comprehensive income							2,531
Parent tax loss allocation	-	356	-	-	-	-	356
Balance as of March 31, 2014	**$ -**	**$ 23,195**	**$ 73**	**$ -**	**$ 73**	**$ 18,379**	**$ 41,647**

The Company had 1,201 shares of common stock authorized, with 1 share issued and outstanding at a par value of $1 per share at March 31, 2014 and 2013.

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

NANTUCKET ELECTRIC COMPANY
NOTES TO THE FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nantucket Electric Company ("the Company") is a retail distribution company providing electric service to approximately 13,000 customers on the Island of Nantucket.

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

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

The Company has evaluated subsequent events and transactions through September 7, 2014 the date of issuance of these financial statements, and concluded that there were no events or transactions that require adjustment to or disclosure in the financial statements as of and for the year ended March 31, 2014.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

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

Regulatory Accounting

The Federal Energy Regulatory Commission ("FERC") and the Massachusetts Department of Public Utilities ("DPU") regulate the rates the Company charges its customers. In certain cases, the rate actions of the DPU can result in accounting that differs from non-regulated companies. In these cases, the Company defers costs (as regulatory assets) or recognizes obligations (as regulatory liabilities) if it is probable that such amounts will be recovered or refunded to customers through future rates. Regulatory assets and liabilities are amortized to the statements of income consistent with the treatment of the related costs in the ratemaking process.

Revenue Recognition

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

As approved by the DPU, the Company is allowed to pass through commodity-related costs to customers and also bills for other approved rate adjustment mechanisms. In addition, the Company has a revenue decoupling mechanism which requires the Company to adjust its base rates annually to reflect the over or under recovery of the Company's targeted base distribution revenues from the prior fiscal year.

Other Taxes

The Company collects taxes and fees from customers such as sales taxes, other taxes, surcharges, and fees that are levied by state or local governments on the sale or distribution of electricity. The Company accounts for taxes that are imposed on customers (such as sales taxes) on a net basis (excluded from revenues).

Income Taxes

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

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

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

Cash and Cash Equivalents

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

Special Deposits

Special deposits primarily include collateral paid to the Company's counterparties for health insurance and worker's compensation.

Accounts Receivable and Allowance for Doubtful Accounts

The Company recognizes an allowance for doubtful accounts to record accounts receivable at estimated net realizable value. During the year ended March 31, 2014, the Company enhanced its estimation methodology. The allowance is determined based on a variety of factors, including for each type of receivable, applying an estimated reserve percentage to each aging category, taking into account historical collection and write-off experience and management's assessment of collectability from individual customers as appropriate. In prior years, the estimate placed a higher emphasis on write off history. Management believes the more fulsome analysis of all information disclosed above results in an improved estimate and the updated approach resulted in an increase of approximately $0.1 million in the reserve. The collectability of receivables is continuously assessed, and if circumstances change, the allowance is adjusted accordingly. Receivable balances are written off against the allowance for doubtful accounts when the accounts are disconnected and/or terminated and the balances are deemed to be uncollectible.

Inventory

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

Fair Value Measurements

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

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

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

Property, Plant and Equipment

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

Depreciation is computed over the estimated useful life of the asset using the composite straight-line method. Depreciation studies are conducted periodically to update the composite rates and are approved by the DPU. The average composite rates for each of the years ended March 31, 2014 and 2013 was 4.8% and 4.4%, respectively. The average service lives for each of the years ended March 31, 2014 and 2013 was 44 years.

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

Allowance for Funds Used During Construction

In accordance with applicable accounting guidance, the Company records AFUDC, which represents the debt and equity costs of financing the construction of new property, plant and equipment. AFUDC equity is reported in the statements of income as non-cash income in other income, net, and AFUDC debt is reported as a non-cash offset to other interest, including affiliate interest. After construction is completed, the Company is permitted to recover these costs through their inclusion in rate base and corresponding depreciation expense. The Company recorded AFUDC related to equity of $11 thousand and AFUDC related to debt of $2 thousand for each of the years ended

March 31, 2014 and 2013, respectively. The average AFUDC rates for the years ended March 31, 2014 and 2013 were 2.0% and 3.4%, respectively.

Goodwill

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

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

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

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

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

Available-For-Sale Securities

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

Employee Benefits

The Company participates with other subsidiaries in defined benefit pension plans ("Pension Plans") and postretirement benefit other than pension ("PBOP") plans for its employees, administered by NGUSA. The Company recognizes its portion of the Pension Plans' and PBOP plans' funded status in the balance sheets as a net liability or asset. The cost of providing these plans is recovered through rates; therefore, the net funded status is offset by a regulatory asset or liability. The Pension Plans' and PBOP plans assets are commingled and cannot be allocated to an individual company. The Company measures and records its pension and PBOP funded status at the year-end date. Pension and PBOP plan assets are measured at fair value, using the year-end market value of those assets.

New and Recent Accounting Guidance

Accounting Guidance Adopted in Fiscal Year 2014

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

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

Accounting Guidance Not Yet Adopted

Reclassifications From Accumulated Other Comprehensive Income

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

3. REGULATORY ASSETS AND LIABILITIES

The Company records regulatory assets and liabilities that result from the ratemaking process. The following table presents the regulatory assets and regulatory liabilities recorded in the accompanying balance sheets.

	March31,	
	2014	2013
	(in thousands of dollars)	
Regulatory assets		
Current:		
Rate adjustment mechanisms	**4,800**	5,440
Total	**4,800**	5,440
Non-current:		
Loss on reacquired debt	**231**	313
Postretirement benefit	**4,114**	3,829
Regulatory deferred tax assets	**336**	28
Other	**17**	27
Total	**4,698**	4,197
Regulatory liabilities		
Current:		
Energy efficiency	**6,202**	5,967
Rate adjustment mechanisms	**10,674**	9,351
Total	**16,876**	15,318
Non-current:		
Cost of removal	**1,568**	1,555
Second cable deferral	**598**	23
Total	**2,166**	1,578
Net regulatory liabilities	**$ (9,544)**	$ (7,259)

Cost of removal: Represents amounts collected, but not yet spent, to dispose of property, plant and equipment. This liability will be discharged as removal costs are incurred.

Energy efficiency: This amount primarily represents the difference between the revenue billed to customers through the Company's energy efficiency charge and the costs of its energy efficiency programs as approved by the DPU.

Postretirement benefits: The amount primarily represents the excess costs of the Company's pension and PBOP plans over amounts received in rates that are deferred to a regulatory asset to be recovered in the future, and the non-cash accrual of net actuarial gains and losses.

Regulatory deferred tax asset: This amount represents unrecovered federal and state deferred taxes of the Company primarily as a result of regulatory flow through accounting treatment and tax rate changes. The income tax benefits or charges for certain plant related timing differences, such as equity AFUDC, are immediately flowed through to or collected from customers. The amortization of the related regulatory deferred tax asset, for these items, follows the book life of the underlying plant asset. The Company recorded an increase in the regulatory deferred tax asset in the current year as a result of the increase in deferred tax liabilities stemming from a Massachusetts state income tax rate change. The Company expects to address the recovery period of the regulatory asset created by the Massachusetts rate change in its next rate case.

Rate adjustment mechanisms: The Company is subject to a number of rate adjustment mechanisms such as for commodity costs, whereby an asset or liability is recognized resulting from differences between actual revenues and the underlying cost being recovered, or differences between actual revenues and targeted amounts as approved by the DPU.

The Company records carrying charges on all regulatory balances, except postretirement benefits, for which cash expenditures have been made and are subject to recovery, or for which cash has been collected and is subject to refund. Carrying charges are not recorded on items for which expenditures have not yet been made.

4. RATE MATTERS

Pursuant to a settlement agreement associated with NGUSA's purchase of the Company in 1996 approved by the DPU, the Company is considered, along with its affiliate Massachusetts Electric Company ("Massachusetts Electric") as one regulated entity for the purpose of recovering its costs and establishing its rates assessed to its customers, with the exception of the recovery of the Company's investment in two undersea electric cables. Pursuant to the settlement agreement, the recovery of this investment is from all of the Company's customers on the Island of Nantucket. Except for the Company's Cable Facilities Surcharge, all rates and charges of the Company and Massachusetts Electric are identical. In the recovery of certain regulatory assets, funding of the recovery is from the customers of both companies. However, the mechanism by which recovery is ultimately achieved is through a single regulatory asset recorded on the balance sheet of Massachusetts Electric. Costs deferred and recovered in this manner are incremental storm costs of qualifying storm events, site investigation and remediation costs, solar generation costs, and any other costs incurred by the companies when taken as a single entity. The Company's share of these costs and recoveries are reflected through the DPU approved return on equity mechanism between the Company and Massachusetts Electric, as discussed in Note 11.

The Company records its own regulatory assets and liabilities associated with rate adjustment mechanisms, loss on reacquired debt, income taxes, postretirement benefits, and energy efficiency as they are specific to the Company. These regulatory assets and liabilities are shown in the table above.

2009 Capital Investment Audit

Rates for services rendered by the Company are subject to approval by the DPU. The DPU approved an RDM arising from the 2009 distribution rate case filed by the Company and its affiliate, Massachusetts Electric. As part of its RDM provision, the Company files a report by July 1st of each year on its capital investment for the prior calendar year. In connection with the Company's first capital expenditure ("CapEx") filing made in July 2010, the DPU opened a proceeding in March 2011, as requested by the Massachusetts Attorney General's Office ("Attorney General"), for an independent audit of the Company's 2009 capital investments which, in part, formed the basis for the Company's RDM rate adjustment. On July 31, 2014, the DPU issued an order approving the sole bidder's bid to perform the CapEx audit. As required by the Order, National Grid has conferred with the Attorney General and the auditor, and on August 21, 2014 National Grid submitted a revised work plan and final contract for the audit to the DPU. After a comment period the DPU will issue a final order on the revised work plan and contract, which will determine the next steps for the audit. The Company cannot currently predict the outcome of this proceeding.

DPU Audit Settlement Agreement

In the general rate case involving the Company's Massachusetts gas distribution affiliates, the DPU opened an investigation to address the allocation and assignment of costs to the gas affiliates by the National Grid service companies. The audit was later expanded to include the Company's Massachusetts electric distribution affiliates. The Company and the Attorney General's Office executed a Settlement Agreement that the DPU approved on July 25, 2014. As a result of the approval of the Settlement, there is no need for an audit, the Company will implement reporting and review practices similar to those in place for its New York affiliates, and NGUSA contributed $1 million to the Massachusetts Association for Community Action that will be used for the benefit of Company's electric customers and customers of its Massachusetts gas distribution affiliates who are eligible for fuel assistance.

Storm Management Audit

In January 2011, the DPU opened an investigation into the Company and Massachusetts Electric's preparation and response to a December 2010 winter storm. The DPU has the authority to issue fines not to exceed approximately $0.3 million for each violation for each day that the violation persists. On September 22, 2011, the DPU approved a settlement between the Company and the Attorney General that included a $1.2 million refund to customers. The DPU also investigated the Company and Massachusetts Electric's response to Tropical Storm Irene and the October 2011 winter storm in a consolidated proceeding. On December 11, 2012, the DPU issued an order in which it assessed the Company and Massachusetts Electric a penalty of $18.7 million associated with the Company and Massachusetts Electric's performance in responding to these two weather events, consisting of $8.1 million for Tropical Storm Irene and $10.6 million for the October 2011 winter storm. The Company and Massachusetts Electric appealed this ruling and on September 4, 2014 the Court affirmed all but two violations, reducing the penalty by $0.9 million. Massachusetts Electric had recorded the original penalty and credited customers during March 2013. In addition, in the December 11, 2012 order, the DPU ordered a management audit of the Company and Massachusetts Electric's emergency planning, outage management, and restoration. The auditors have completed their audit, and submitted their Final Report to the DPU on July 9, 2014. No parties submitted comments on the Final Report. The Company cannot predict the outcome of the management audit.

5. PROPERTY, PLANT AND EQUIPMENT

The following table summarizes property, plant and equipment at cost along with accumulated depreciation and amortization:

	March 31,	
	2014	2013
	(in thousands of dollars)	
Plant and machinery	**$ 107,854**	$ 105,920
Land and buildings	**4,436**	4,416
Assets in construction	**1,100**	332
Total property, plant and equipment	**113,390**	110,668
Accumulated depreciation and amortization	**(43,849)**	(40,662)
Property, plant and equipment, net	**$ 69,541**	$ 70,006

6. FAIR VALUE MEASUREMENTS

The following tables present available for sale securities measured and recorded at fair value in the accompanying balance sheets on a recurring basis and their level within the fair value hierarchy as of March 31, 2014 and 2013:

	March 31, 2014			
	Level 1	**Level 2**	**Level 3**	**Total**
	(in thousands of dollars)			
Assets:				
Available-for-sale securities	347	478	-	825

	March 31, 2013			
	Level 1	Level 2	Level 3	Total
		(in thousands of dollars)		
Assets:				
Available-for-sale securities	323	435	-	758

A transfer into Level 3 represents existing assets or liabilities that were previously categorized at a higher level for which the inputs became unobservable during the year. A transfer out of Level 3 represents assets and liabilities that were previously classified as Level 3 for which the inputs became observable based on the criteria discussed previously for classification in Level 2. These transfers, which are recognized at the end of each period, result from changes in the observability of forward curves from the beginning to the end of each reporting period. There were no transfers between Level 1 and Level 2, and no transfers into or out of Level 3, during the years ended March 31, 2014 or 2013.

Available-for-sale securities are included in other non-current assets in the accompanying balance sheets and primarily include equity and debt investments based on quoted market prices (Level 1) and municipal and corporate bonds based on quoted prices of similar traded assets in open markets (Level 2).

Other Fair Value Measurements

The Company's balance sheets reflect long-term debt at amortized cost. The fair value of the Company's long-term debt was estimated using quoted market prices for similar debt. The fair value of this debt at March 31, 2014 and 2013 was $52.0 million and $52.3 million, respectively.

All other financial instruments in the accompanying balance sheets such as accounts receivable, accounts payable, and the intercompany money pool are stated at cost, which approximates fair value.

7. EMPLOYEE BENEFITS

The Company participates with other NGUSA subsidiaries in a qualified and non-qualified non-contributory defined benefit plan (the "Pension Plan") and PBOP plan (together with the Pension Plan (the "Plan") covering substantially all employees.

The Pension Plan is a defined benefit plan which provides union employees, as well as non-union employees hired before January 1, 2011, with a retirement benefit. Supplemental nonqualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives. The PBOP Plan provides health care and life insurance coverage to eligible retired employees. Eligibility is based on age and length of service requirements and, in most cases, retirees must contribute to the cost of their coverage.

During each of the years ended March 31, 2014 and 2013, the Company made contributions of approximately $0.3 million and $0.4 million to the Plan.

Plan assets are commingled and cannot be allocated to an individual company. The Plan's costs are first directly charged to the Company based on the Company's employees that participate in the Plan. Costs associated with affiliated service companies' employees are then allocated as part of the labor burden for work performed on the Company's behalf. The Company applies deferral accounting for pension and PBOP expenses associated with its regulated electric operations. Any differences between actual pension costs and amounts used to establish rates are deferred and collected from or refunded to customers in subsequent periods. Pension and PBOP expense is included in operations and maintenance expense in the accompanying statements of income.

The NGUSA companies' pension and PBOP plans that the Company participates in have unfunded obligations at March 31, 2014 and 2013 as follows:

	March 31,	
	2014	2013
	(in thousands of dollars)	
Pension	**$ 402,928**	$ 471,000
PBOP	**302,360**	368,100
	$ 705,288	$ 839,100

The Company's net pension and PBOP expenses directly charged and allocated from affiliated service companies, net of capital, for the years ended March 31, 2014 and 2013 are as follows:

	March 31,	
	2014	2013
	(in thousands of dollars)	
Pension	**$ 390**	$ 322
PBOP	**220**	182
	$ 610	$ 504

Defined Contribution Plan

NGUSA has a defined contribution pension plan that covers substantially all employees. For the years ended March 31, 2014 and 2013, the Company recognized an expense in the accompanying statements of income of $39 thousand and $0.1 million, respectively, for matching contributions.

Other Benefits

During the year ended March 31, 2014, NGUSA improved its methodology for allocating to its subsidiaries the expense and liability for workers compensation, auto, and general insurance claims which have been incurred but not yet reported ("IBNR"). In prior years, such costs and liabilities were allocated to NGUSA's subsidiaries based on each subsidiary's pro-rata share of known outstanding case reserves. As of and for the year ended March 31, 2014, such IBNR amounts are allocated proportionally based on various factors including revenue, payroll, and number of fleet vehicles, as applicable to the related exposure source. Management believes this improved methodology provides a more accurate and appropriate allocation to each of its subsidiaries. The change in allocation methodology resulted in an increase in income before taxes of approximately $0.4 million in the current fiscal year. At March 31, 2014 and 2013, the Company had accrued IBNR of $0.1 million and $0.2 million respectively.

8. CAPITALIZATION

Debt Authorizations

The Company had regulatory approval from the FERC to issue up to $15 million of short-term debt, which expired on November 30, 2013. Effective April 2014, the Company entered into an Equity Contribution Agreement with the Parent which provides the Company with the ability to call upon the Parent for contributions to the Company's capital, in an aggregate amount equal to the short-term borrowing limit until such time as regulatory approval for short-term borrowing is regained. The Company has not made use of this facility since its effective date. The Company had no short-term debt outstanding to third parties as of March 31, 2014 or 2013.

Long-term Debt

At March 31, 2014, the Company had $52.0 million outstanding of Electric Revenue Bonds in tax exempt commercial paper mode with maturity dates ranging from 2016 through 2042. The debt is remarketed at periods of 1-270 days, and had variable interest rates ranging from 0.30% to 0.50% and from 0.38% to 0.55% for the years ended March 31, 2014 and 2013, respectively. The bonds were issued by the Massachusetts Development Finance Agency in connection with the Company's financing of its first and second underground and submarine cable projects. A sinking fund payment of $0.3 million was made during the year ended March 31, 2014.

The Company has a Standby Bond Purchase Agreement ("SBPA") of $52.6 million which expires on November 20, 2015. This agreement was available to provide liquidity support for $52.0 million of the Company's long-term bonds in tax-exempt commercial paper mode. The Company has classified this debt as long-term due to its intent and ability to refinance the debt on a long-term basis if is not able to remarket it. At March 31, 2014 and 2013, there were no bond purchases made by the banks participating in this agreement.

Massachusetts Electric, an affiliated entity, unconditionally guarantees the full and prompt payment of the principal, premium, if any, and interest on certain tax exempt bonds issued by the Massachusetts Development Finance Agency in connection with the Company's financing of its first and second underground and submarine cable projects. Massachusetts Electric would be required to make any principal, premium, or interest payments if the Company failed to pay.

The aggregate maturities of long-term debt subsequent to March 31, 2014 are as follows:

(in thousands of dollars) Years Ending March 31,		
2015	$	330
2016		365
2017		-
2018		-
2019		-
Thereafter		51,300
Total	$	51,995

Dividend Restrictions

The Company is obligated to meet certain financial and non-financial covenants as described below. The Company was in compliance with all such covenants during the years ended March 31, 2014 and 2013.

Pursuant to provisions in connection with the New England Electric System and Eastern Utilities Associates merger, payment of dividends on common stock are not permitted if, after giving effect to such payment of dividends, common equity becomes less than 30% of total capitalization. At March 31, 2014 and 2013 common equity was 44% and 43% of total capitalization, respectively. Under these provisions, none of the Company's retained earnings at March 31, 2014 and 2013 were restricted as to common dividends.

9. INCOME TAXES

Components of Income Tax Expense

	Years Ended March 31,	
	2014	2013
	(in thousands of dollars)	
Current tax expense (benefit):		
Federal	**$ 1,924**	$ (53)
State	**666**	51
Total current tax expense (benefit)	**2,590**	(2)
Deferred tax expense (benefit):		
Federal	**(692)**	432
State	**(121)**	120
	(813)	552
Amortized investment tax credits [1]	**-**	(1)
Total deferred tax expense (benefit)	**(813)**	551
Total income tax expense	**$ 1,777**	$ 549

[1] Investment tax credits (ITC) are being deferred and amortized over the depreciable life of the property giving rise to the credits

Statutory Rate Reconciliation

The Company's effective tax rate for the years ended March 31, 2014 and 2013 is 41% and 19%, respectively. The following table presents a reconciliation between the income tax expense at the federal statutory tax rate of 35% to the actual tax expense from continuing operations:

	Years Ended March 31,	
	2014	2013
	(in thousands of dollars)	
Computed tax	**$ 1,505**	$ 990
Change in computed taxes resulting from:		
State income tax, net of federal benefit	**354**	119
Investment tax credit	**-**	(1)
Adjustments related to prior year, federal and state	**(20)**	(549)
Other items - net	**(62)**	(10)
Total	**272**	(441)
Federal and state income taxes	**$ 1,777**	$ 549

The Company is included in the NGNA and subsidiaries consolidated federal income tax return. The Company has joint and several liability for any potential assessments against the consolidated group.

In September 2013, the Internal Revenue Service ("IRS") issued final regulations, effective for tax years beginning in 2014, that provide guidance on the appropriate tax treatment of costs incurred to acquire, produce or improve tangible property, as well as routine maintenance and repair costs. Proposed regulations were issued addressing the tax treatment of asset dispositions. The Company has evaluated tax accounting method changes that may be elected or required by the final regulations. At March 31, 2014, $73 thousand of deferred tax liabilities have been classified as current in the accompanying balance sheets, representing the cumulative adjustment expected to be reflected in income for tax purposes during the twelve months ending March 31, 2015. The application of these regulations is not expected to have a material impact on the Company's financial position, results of operations or cash flow.

On July 24, 2013, Massachusetts legislature enacted into law transportation finance legislation which included significant tax changes affecting the classification of utility corporations. For tax years beginning on or after January 1, 2014, Massachusetts utility corporations will be taxed in the same manner as general business corporations. The state income tax rate will increase from 6.5% to 8.0%. Also, any unitary NOL generated post-2013 and allocated to the utilities will be allowed as a carry forward tax attribute. As of March 31, 2014, all state deferred tax balances at the regulated utilities were remeasured to the 8% rate, resulting in an increase in deferred tax liabilities of $313 thousand with an offset to regulatory deferred tax asset. The application of this legislation is not expected to have a material impact on the Company's financial position, results of operations or liquidity.

Significant components of the Company's net deferred tax assets and liabilities at March 31, 2014 and 2013 are as follows:

	March 31,	
	2014	2013
	(in thousands of dollars)	
Deferred tax assets:		
Other regulatory liabilities, net	**$ 7,249**	$ 3,753
Pensions, PBOP and other employee benefits	**2,277**	2,005
Future federal benefit on state taxes	**613**	481
Other items	**80**	68
Total deferred tax assets [1]	**10,219**	6,307
Deferred tax liabilities:		
Property related differences	**15,821**	14,711
Regulatory assets - pension and PBOP	**1,848**	1,366
Regulatory assets - other	**1,803**	-
Other items	**139**	123
Total deferred tax liabilities	**19,611**	16,200
Net deferred income tax liability	**9,392**	9,893
Deferred investment tax credits	**1**	1
Net deferred income tax liability and investment tax credits	**9,393**	9,894
Current portion of net deferred income tax asset	**4,860**	3,949
Non-current deferred income tax liability and investment tax credits	**$ 14,253**	$ 13,843

[1] There were no valuation allowances for deferred tax assets at March 31, 2014 or 2013.

The following table presents the amounts and expiration dates of operating losses as of March 31, 2014:

Expiration of net operating losses:	Federal
	(in thousands of dollars)
03/31/2029	$ 3,966
03/31/2030	(3)

Unrecognized Tax benefits

As of March 31, 2014 and 2013, the Company's unrecognized tax benefits totaled \$1.4 million and \$1.2 million, respectively, of which none would affect the effective tax rate, if recognized. The unrecognized tax benefits are included in other non-current liabilities in the accompanying balance sheets.

The following table presents changes to the Company's unrecognized tax benefits for the years ended March 31, 2014 and 2013:

	Years Ended March 31,	
	2014	2013
	(in thousands of dollars)	
Beginning balance	**\$ 1,229**	\$ 1,242
Gross increases related to prior period	**218**	7
Gross decreases related to prior period	**-**	(11)
Gross increases related to current period	**-**	20
Gross decreases related to current period	**-**	(29)
Settlements with tax authorities	**-**	-
Reductions due to lapse of statute of limitations	**-**	-
Ending balance	**\$ 1,447**	\$ 1,229

As of March 31, 2014 and 2013, the Company has accrued for interest related to unrecognized tax benefits of \$17 thousand and \$7 thousand, respectively. During years ended March 31, 2014 and 2013, the Company recorded interest expense of \$10 thousand and \$2 thousand, respectively. The Company recognizes accrued interest related to unrecognized tax benefits in other interest, including affiliate interest and related penalties, if applicable, in other income, net in the accompanying statements of income. No penalties were recognized during the years ended March 31, 2014 and 2013.

It is reasonably possible that other events will occur during the next 12 months that would cause the total amount of unrecognized tax benefits to increase or decrease. However, the Company does not believe any such increases or decreases would be material to their results of operations, financial position, or cash flows.

Federal income tax returns have been examined and all appeals and issues have been agreed with the IRS and the NGNA consolidated filing group, through March 31, 2007.

During fiscal year 2014 the IRS concluded its examination of the NGNA consolidated filing group's corporate income tax returns for the periods ended March 31, 2008 and March 31, 2009. The examinations were completed on March 31, 2014, with an agreement on the majority of income tax issues for the years referenced above, as well as an acknowledgment that certain discrete items remain disputed. NGNA is in the process of appealing these disputed items with the IRS Office of Appeals. The Company does not anticipate a change in its unrecognized tax positions in the next twelve months as a result of the appeals. However, pursuant to the Company's tax sharing agreement, the audit or appeals may result in a change to allocated tax. Fiscal years ended March 31, 2010 through March 31, 2014 remain subject to examination by the IRS.

The Company is a member of the National Grid USA Service Company Massachusetts unitary group since fiscal year ended March 31, 2010. The tax returns for the fiscal years ended March 31, 2010 through March 31, 2014 remain subject to examination by the State of Massachusetts.

The following table indicates the earliest tax year subject to examination:

Jurisdiction	Tax Year
Federal	March 31, 2008*
Massachusetts	March 31, 2010

*The NGNA consolidated filing group is in the process of appealing certain disputed issues with the IRS Office of Appeals for the fiscal years ended March 31, 2008 through March 31, 2009.

10. COMMITMENTS AND CONTINGENCIES

Capital Expenditures

The Company has various capital commitments related to the construction of property, plant and equipment. The Company's commitments under these contracts subsequent to March 31, 2014 are $0.3 million, which is due to be spent within one year.

Legal Matters

The Company is subject to various legal proceedings, primarily injury claims, arising out of the ordinary course of its business. The Company does not consider any of such proceedings to be material, individually or in the aggregate, to its business or likely to result in a material adverse effect on its results of operations, financial position, or cash flows.

11. RELATED PARTY TRANSACTIONS

Advance from Affiliate

The Company had an agreement with NGUSA whereby the Company can borrow up to $10 million from time to time for working capital needs. In November 2014, the Company entered into another agreement with NGUSA whereby the Company can borrow an additional $10 million from for working capital needs. The advance is non-interest bearing. At March 31, 2014 and 2013, the Company had an outstanding advance from affiliate of $20 million and zero, respectively.

Accounts Receivable from and Accounts Payable to Affiliates

NGUSA and its affiliates provide various services to the Company, including executive and administrative, customer services, financial (including accounting, auditing, risk management, tax and treasury/finance), human resources, information technology, legal and strategic planning, that are charged between the companies and charged to each company.

The Company records short-term payables to and receivables from certain of its affiliates in the ordinary course of business. The amounts payable to and receivable from its affiliates do not bear interest and are settled through the intercompany money pool.

A summary of net outstanding accounts receivable from affiliates and accounts payable to affiliates balances is as follows:

	Accounts Receivable from Affiliates		Accounts Payable to Affiliates	
	March 31,		March 31,	
	2014	2013	**2014**	2013
	(in thousands of dollars)		*(in thousands of dollars)*	
Massachusetts Electric Company	**$ -**	$ 1,704	**8,356**	$ -
NG Engineering Services, LLC	**75**	43	**-**	-
New England Power Company	**-**	-	**571**	370
The Narragansett Electric Company	**-**	-	**185**	249
Keyspan Gas East Corporation	**174**	-	**-**	1
Niagara Mohawk Power Corporation	**-**	-	**-**	41
Boston Gas Company	**177**	-	**-**	43
NGUSA Service Company	**-**	-	**234**	923
Other	**23**	27	**65**	20
Total	**$ 449**	$ 1,774	**$ 9,411**	$ 1,647

Intercompany Money Pool

The settlement of the Company's various transactions with NGUSA and certain affiliates generally occurs via the intercompany money pool. The Company is a participant in the Regulated Money Pool and can both borrow and lend funds. Borrowings from the Regulated Money Pool bear interest in accordance with the terms of the intercompany money pool agreement. As the Company fully participates in the Regulated Money Pool rather than settling intercompany charges with cash, all changes in the intercompany money pool balance and accounts receivable and payable from affiliate balances, are reflected as investing or financing activities in the accompanying statements of cash flows. In addition, for the purpose of presentation in the statement of cash flows, it is assumed all amounts settled through intercompany money pool are constructive cash receipts and payments, and therefore are presented as such.

The Regulated Money Pool is funded by operating funds from participants. Collectively, NGUSA and its subsidiary, KeySpan have the ability to borrow up to $3 billion from National Grid plc for working capital needs including funding of the intercompany money pools, if necessary. The Company had short-term intercompany money pool investments of $60.8 million and $25.8 million at March 31, 2014 and 2013, respectively. The average interest rates for the intercompany money pool were 0.7% and 0.6% for the years ended March 31, 2014 and 2013, respectively.

Related Party Reimbursement

In accordance with the Credit and Operating Support Agreement dated March 26, 1996, Massachusetts Electric will reimburse the Company an amount equal to the difference between the Company's actual net income for the year and the net income necessary for the Company to earn a return on equity ("ROE") equivalent to the Company's DPU approved weighted average allowed ROE for the fiscal year, currently 10.35%. This reimbursement shall constitute additional revenue to the Company and expense to Massachusetts Electric. If the Company's actual ROE for the year exceeds the Company's allowed ROE, the Company reimburses to Massachusetts Electric the excess amount of the earnings. For the years ended March 31, 2014 and 2013, Massachusetts Electric reimbursed the Company $5.8 million and $3.8 million, respectively.

Service Company Charges

The affiliated service companies of NGUSA provide certain services to the Company at their cost. The service company costs are generally allocated to associated companies through a tiered approach. First and foremost, costs are directly charged to the benefited company whenever practicable. Secondly, in cases where direct charging cannot be readily determined, costs are typically allocated using cost/causation principles linked to the relationship of that type of service, such as number of employees, number of customers/meters, capital expenditures, value of property owned, total transmission and distribution expenditures, etc. Lastly, all other costs are allocated based on a general allocator determined using a 3-point formula based on net margin, net property, plant and equipment, and operations and maintenance expense.

Charges from the service companies of NGUSA to the Company for the years ended March 31, 2014 and 2013 were $4.1 million and $4.5 million, respectively.

Holding Company Charges

NGUSA received charges from National Grid Commercial Holdings Limited (an affiliated company in the U.K.) for certain corporate and administrative services provided by the corporate functions of National Grid plc to its U.S. subsidiaries. These charges, which are recorded on the books of NGUSA, have not been reflected on these financial statements. Were these amounts allocated to the Company, the estimated effect on net income would be $101 thousand and $45 thousand before taxes, and $60 thousand and $29 thousand after taxes, for the years ended March 31, 2014 and 2013, respectively.