nationalgrid

KeySpan Gas East Corporation
d/b/a National Grid

Financial Statements

For the years ended March 31, 2014 and 2013

KEYSPAN GAS EAST CORPORATION

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Independent Auditor's Report

To the Shareholders and Board of Directors
of Keyspan Gas East Corporation

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

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the 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 Keyspan Gas East Corporation 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

August 15, 2014

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KEYSPAN GAS EAST CORPORATION
STATEMENTS OF INCOME
(in thousands of dollars)

	Years Ended March 31,	
	2014	2013
Operating revenues	**$ 1,083,399**	$ 958,118
Operating expenses:		
Purchased gas	**438,931**	353,150
Operations and maintenance	**320,562**	271,962
Depreciation and amortization	**60,580**	57,371
Other taxes	**134,695**	132,258
Total operating expenses	**954,768**	814,741
Operating income	**128,631**	143,377
Other income and (deductions):		
Interest on long-term debt	**(34,828)**	(34,858)
Other interest, including affiliate interest	**(9,380)**	(7,247)
Other deductions, net	**(4,466)**	(17,828)
Total other deductions, net	**(48,674)**	(59,933)
Income before income taxes	**79,957**	83,444
Income tax expense	**30,139**	34,694
Net income	**$ 49,818**	$ 48,750

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

KEYSPAN GAS EAST CORPORATION
STATEMENTS OF CASH FLOWS
(in thousands of dollars)

	Years Ended March 31,	
	2014	2013
Operating activities:		
Net income	**$ 49,818**	$ 48,750
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**60,580**	57,371
Regulatory amortizations	**46,365**	35,049
Provision for deferred income taxes	**41,598**	35,394
Bad debt expense	**13,401**	528
Allowance for equity funds used during construction	**-**	(1,100)
Net postretirement benefit contributions	**(5,912)**	(8,726)
Net environmental remediation payments	**(38,333)**	(35,532)
Changes in operating assets and liabilities:		
Accounts receivable, net, and unbilled revenues	**(58,327)**	(134,962)
Inventory	**16,483**	35,486
Regulatory assets and liabilities	**(32,584)**	50,767
Derivative contracts	**(2,955)**	(13,532)
Prepaid and accrued taxes	**(12,838)**	(3,443)
Accounts payable and other liabilities	**(44,107)**	47,841
Other, net	**8,383**	1,404
Net cash provided by operating activities	**41,573**	115,295
Investing activities:		
Capital expenditures	**(189,205)**	(143,878)
Cost of removal	**(17,133)**	(17,555)
Insurance proceeds applied to capital expenditures	**14,278**	14,423
Net cash used in investing activities	**(192,060)**	(147,010)
Financing activities:		
Dividends to Parent	**-**	(250,000)
Affiliated money pool borrowing and receivables/payables, net	**155,897**	279,349
Other	**-**	16
Net cash provided by financing activities	**155,897**	29,365
Net increase in cash and cash equivalents	**5,410**	(2,350)
Cash and cash equivalents, beginning of year	**3,273**	5,623
Cash and cash equivalents, end of year	**$ 8,683**	$ 3,273
Supplemental disclosures:		
Interest paid	**$ 43,599**	$ 37,321
Income taxes refunded from Parent	**7,454**	21,221
State income taxes paid	**8,493**	2,005
Significant non-cash item:		
Capital-related accruals included in accounts payable	**26,517**	12,542

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

KEYSPAN GAS EAST CORPORATION
BALANCE SHEETS
(in thousands of dollars)

	March 31,	
	2014	2013
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 8,683**	$ 3,273
Accounts receivable	**299,390**	260,288
Allowance for doubtful accounts	**(19,656)**	(18,705)
Other receivable	**38,995**	42,192
Accounts receivable from affiliates	**28,690**	49,822
Unbilled revenues	**79,076**	69,104
Inventory	**27,246**	43,729
Regulatory assets	**96,722**	64,323
Derivative contracts	**11,156**	14,261
Other	**28,460**	19,775
Total current assets	**598,762**	548,062
Property, plant, and equipment, net	**2,510,609**	2,358,371
Other non-curent assets:		
Regulatory assets	**485,316**	543,792
Goodwill	**1,018,407**	1,018,407
Derivative contracts	**11,199**	3,165
Other	**4,032**	5,476
Total other non-current assets	**1,518,954**	1,570,840
Total assets	**$ 4,628,325**	$ 4,477,273

The accompanying notes are an integral part of these financial statements

KEYSPAN GAS EAST CORPORATION
BALANCE SHEETS
(in thousands of dollars)

	March 31,	
	2014	2013
LIABILITIES AND CAPITALIZATION		
Current liabilities:		
Accounts payable	**$ 41,062**	$ 62,698
Accounts payable to affiliates	**86,112**	104,914
Intercompany money pool	**551,609**	398,042
Customer deposits	**8,995**	8,613
Taxes accrued	**15,419**	17,767
Interest accrued	**19,885**	22,394
Regulatory liabilities	**29,389**	24,742
Derivative contracts	**2,060**	349
Current portion of deferred income tax liabilities	**37,686**	27,262
Other	**11,094**	8,866
Total current liabilities	**803,311**	675,647
Other non-current liabilities:		
Regulatory liabilities	**286,296**	242,690
Asset retirement obligations	**14,078**	13,281
Postretirement benefits	**211,509**	261,364
Environmental remediation costs	**70,432**	108,426
Derivative contracts	**1,266**	1,003
Deferred income tax liabilities	**631,706**	592,522
Other	**30,770**	53,201
Total other non-current liabilities	**1,246,057**	1,272,487
Commitments and contingencies (Note 12)		
Capitalization:		
Shareholders' equity	**1,978,957**	1,929,139
Long-term debt	**600,000**	600,000
Total capitalization	**2,578,957**	2,529,139
Total liabilities and capitalization	**$ 4,628,325**	$ 4,477,273

The accompanying notes are an integral part of these financial statements

KEYSPAN GAS EAST CORPORATION
STATEMENTS OF CAPITALIZATION
(in thousands of dollars)

			March 31,	
			2014	2013
Total shareholders' equity			**$ 1,978,957**	$ 1,929,139
Long-term debt:	Interest Rate	Maturity Date		
Unsecured notes:				
Senior Note	5.60%	November 29, 2016	**100,000**	100,000
Senior Note	5.82%	April 1, 2041	**500,000**	500,000
Total long-term debt			**600,000**	600,000
Total capitalization			**$ 2,578,957**	$ 2,529,139

The accompanying notes are an integral part of these financial statements

KEYSPAN GAS EAST CORPORATION
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(in thousands of dollars)

	Common Stock	Preferred Stock	Additional Paid-in Capital	Retained Earnings	Total
Balance as of March 31, 2012	$ -	$ -	$ **2,014,878**	$ **115,495**	$ **2,130,373**
Net income	-	-	-	48,750	48,750
Share based compensation	-	-	16	-	16
Dividends to KeySpan Corporation	-	-	(134,505)	(115,495)	(250,000)
Balance as of March 31, 2013	$ -	$ -	$ **1,880,389**	$ **48,750**	$ **1,929,139**
Net income	-	-	-	49,818	49,818
Balance as of March 31, 2014	$ -	$ -	$ **1,880,389**	$ **98,568**	$ **1,978,957**

The Company had 100 shares of common stock authorized, issued and outstanding, with a par value of $0.01 per share and 1 share of preferred stock authorized, issued and outstanding, with a par value of $1 per share at March 31, 2014 and 2013.

The accompanying notes are an integral part of these financial statements

KEYSPAN GAS EAST CORPORATION
NOTES TO THE FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

KeySpan Gas East Corporation d/b/a National Grid ("the Company") distributes natural gas to approximately 505,000 retail customers and transports natural gas to approximately 75,000 customers in Nassau and Suffolk Counties in Long Island, New York and the Rockaway Peninsula in Queens, New York.

The Company is a wholly-owned subsidiary of KeySpan Corporation ("KeySpan" or the "Parent"), which is a wholly-owned subsidiary of National Grid USA ("NGUSA"), 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 August 15, 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 New York Public Service Commission ("NYPSC") regulates the rates the Company charges its customers. In certain cases, the rate actions of the NYPSC 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 from 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 gas distribution services 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.

With respect to base distribution rates, the NYPSC has approved a Revenue Decoupling Mechanism ("RDM"), which applies only to the Company's firm residential heating sales and transportation customers. The RDM 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 year (May – April).

The Company's tariff includes a cost of gas adjustment factor ("CGAF") which requires an annual reconciliation of recoverable gas costs and revenues. Any difference is deferred pending recovery from, or refund to, customers. The gas distribution business is influenced by seasonal weather conditions and, therefore, the Company's tariff contains a weather normalization adjustment that provides for recovery from, or refund to, customers of material shortfalls or excesses of delivery revenues (revenues less applicable gas costs and revenue taxes) during a heating season due to variations from normal weather.

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 gas. The Company accounts for taxes that are imposed on customers (such as sales taxes) on a net basis (excluded from revenues), while taxes imposed on the Company, such as excise taxes, are recognized on a gross basis. Excise taxes collected and paid for the years ended March 31, 2014 and 2013 were $12.0 million and $13.8 million, respectively.

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

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.

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 did not materially change 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 as well as gas in storage. Materials and supplies are stated at the lower of weighted average cost or market and are expensed or capitalized as used. The Company's policy is to write-off obsolete inventory; there were no material write-offs of obsolete inventory for the years ended March 31, 2014 or 2013.

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

The Company had materials and supplies of $4.5 million and $13.5 million and gas in storage of $22.7 million and $30.2 million at March 31, 2014 and 2013, respectively.

Derivatives

The Company uses derivative instruments for commodity price risk management. All derivative contracts are recorded on the accompanying balance sheets at their fair value. Commodity costs, including derivative contracts, are passed on to customers through the Company's gas cost adjustment mechanism. Therefore, gains or losses on the settlement of these contracts are initially deferred and then refunded to, or collected from customers consistent with regulatory requirements.

The Company's accounting policy is to present on a gross basis, fair value amounts recognized for derivative instruments and related cash collateral receivable or payable with the same counterparty under a master netting agreement. The related cash collateral is recorded as special deposits in the accompanying balance sheets. There were no special deposits as of March 31, 2014 or 2013.

Fair Value Measurements

The Company measures derivatives 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 NYPSC. The average composite rate for each of the years ended March 31, 2014 and 2013 was 2.0% and 2.9% respectively. The average service lives for each of the years ended March 31, 2014 and 2013 was 35 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 $49.1 million and $42.3 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 deductions, net and AFUDC debt is reported as a non-cash offset to other interest, including affiliate interest. After construction is completed, the Company is permitted to recover these costs through their inclusion in rate base and corresponding depreciation expense. The Company recorded AFUDC related to equity of zero and $1.1 million and AFUDC related to debt of $0.5 million and $0.4 million for the years ended March 31, 2014 and 2013 respectively. The average AFUDC rates for the years ended March 31, 2014 and 2013 were 0.7% and 5.7% 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.

Asset Retirement Obligations

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

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

	Years Ended March 31,	
	2014	2013
	(in thousands of dollars)	
Balance as of the beginning of the year	**$ 13,281**	$ 12,529
Accretion expense	**797**	752
Balance as of the end of the year	**$ 14,078**	$ 13,281

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

Employee Benefits

The Company participates with other KeySpan subsidiaries in defined benefit pension plans ("Pension Plans") and postretirement benefit other than pension ("PBOP") plans for its employees, administered by the Parent. The Company recognizes its portion of the Pension plans' and PBOP plan's 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 plan's 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

Offsetting Assets and Liabilities

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

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

In July 2013, the FASB issued amendments to address diversity in practice related to the presentation of unrecognized tax benefits in certain situations. The amendments require a liability related to an unrecognized tax benefit to be presented on a net basis with its associated deferred tax asset when utilization of such deferred tax assets is required or expected in the event the uncertain tax position is disallowed. Otherwise, the unrecognized tax benefit will be presented as a liability and

will not be netted against deferred tax assets. The Company early adopted this guidance effective April 1, 2013 with no material impact on its financial position, results of operations or cash flows.

Financial Statement Revision

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

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

A cumulative adjustment of $21.6 million (net of income taxes) was recorded in the financial statements for the year ended March 31, 2013 of which $20.7 million was recorded as a decrease to opening retained earnings (as of March 31, 2012), and $0.9 million was recorded as a decrease to net income within operations and maintenance expense and other income and deductions for the year ended March 31, 2013 to reflect the fiscal year 2013 activity related to this correction. This adjustment also resulted in a decrease of $52.7 million in non-current regulatory assets, a decrease of $16.7 million in non-current regulatory liabilities and a decrease of $14.6 million in deferred income tax liabilities as of March 31, 2013.

In addition, the Company has corrected various account balances which were improperly recorded. A cumulative adjustment of $1.4 million (net of income taxes) was recorded in the financial statements for the year ended March 31, 2013, of which $3.2 million was recorded as an adjustment to opening retained earnings (as of March 31, 2012), and $1.8 million was recorded as an increase to net income for the year ended March 31, 2013 to reflect the fiscal year 2013 activity related to these items.

The following table shows the amounts previously reported as revised:

	As Previously Reported[i]	Adjustments	As Revised
	(in thousands of dollars)		
	March 2013		March 2013
Statement of Income			
Operating revenues	$ 957,563	$ 555	$ 958,118
Operating income	138,363	5,014	143,377
Other income and (deductions)	(21,404)	(3,671)	(25,075)
Income before income taxes	82,101	1,343	83,444
Income tax expense	34,226	468	34,694
Net income	47,875	875	48,750
Statement of Cash Flows			
Net income	47,875	875	48,750
Net cash provided by operating activities	113,562	1,733	115,295
Net cash used in investing activities	(147,395)	385	(147,010)
Net cash used in financing activities	31,367	(2,002)	29,365
Balance Sheet			
Total current assets	561,993	(13,931)	548,062
Property, plant, and equipment, net	2,358,756	(385)	2,358,371
Total other non-current assets	1,621,639	(50,799)	1,570,840
Total current liabilities	677,306	(1,659)	675,647
Total other non-current liabilities	1,313,137	(40,650)	1,272,487
Additional paid in capital	1,904,070	(23,681)	1,880,389
Retained Earnings			
March 31, 2013	47,875	875	48,750
March 31, 2012	138,954	(23,459)	115,495

(i) During the year ended March 31, 2014, the Company changed its accounting policy for presentation of tax balances. The change in policy resulted in a reclassification of balances reported at March 31, 2013.

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:			
	Environmental response costs	**$ 25,147**	$ 43,101
	Gas cost adjustment	**51,465**	-
	Postretirement benefits	**14,066**	16,906
	Other	**6,044**	4,316
		96,722	64,323
Non-current:			
	Carrying charges	**7,501**	6,447
	Environmental response costs	**260,921**	284,722
	Postretirement benefits	**110,201**	165,339
	Property taxes	**36,704**	18,405
	Rate mitigation	**26,635**	24,608
	Other	**43,354**	44,271
	Total	**485,316**	**543,792**
Regulatory liabilities			
Current:			
	Derivative contracts	**11,156**	14,261
	Gas cost adjustment	**-**	5,665
	Temporary state assessment	**18,218**	1,596
	Other	**15**	3,220
		29,389	24,742
Non-current:			
	Capital tracker	**36,504**	27,016
	Cost of removal	**49,095**	42,312
	Delivery rate adjustment	**82,870**	82,871
	Postretirement benefits	**48,666**	44,866
	Other	**69,161**	45,625
	Total	**286,296**	242,690
	Net regulatory assets	**$ 266,353**	$ 340,683

Capital tracker: During the primary term of the rate plan (2008–2012), which remains in effect until modified by the NYPSC, the Company had a capital tracker mechanism that reconciled the Company's capital expenditures to the amounts permitted in rates. The mechanism provided for a two way (upward and downward) tracker for City and State Construction ("CSC") related expenditures and a one way (downward only) tracker for all other capital expenditures. The Company deferred the full revenue requirement equivalent of CSC expenditures above or below the CSC rate as well as the full revenue requirement equivalent of amounts below the rate allowance for all other capital expenditures.

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

Delivery rate adjustment: The NYSPSC authorized a surcharge for recovery of regulatory assets (Delivery Rate Surcharge) of $10.0 million beginning January 1, 2009, which increased incrementally by $10.0 million and aggregating to approximately $100 million over the term of the rate agreement. In its order issued and effective November 28, 2012, the NYSPSC authorized a site investigation and remediation (“SIR”) surcharge in the amount of $40 million which superseded the

Delivery Rate Surcharge effective January 1, 2013. The SIR surcharge is reflected as environmental response costs and will be used to amortize existing SIR deferral balances.

Derivative assets and liabilities: Gains or losses resulting from commodity derivatives are typically required to be refunded to or recovered from customers through the gas cost adjustment. Accordingly, the Company evaluates open derivative contracts to determine if they are probable of recovery or refund through future rates charged to customers and qualify for regulatory deferral. Derivative contracts that qualify for regulatory deferral are recorded at fair value, with changes in fair value recorded as regulatory assets or regulatory liabilities in the period in which the change occurs.

Environmental response costs: This regulatory asset represents deferred costs associated with the estimated costs to investigate and perform certain remediation activities at former manufactured gas plant ("MGP") sites and related facilities. The Company believes future costs, beyond the expiration of current rate plans, will continue to be recovered through rates.

Gas cost adjustment: The Company is subject to rate adjustment mechanisms for commodity costs, whereby an asset or liability is recognized resulting from differences between actual revenues and the underlying cost being recovered or differences between actual revenues and targeted amounts as approved by the NYPSC. These amounts will be refunded to, or recovered from, customers over the next year.

Property taxes: The regulatory assets and liabilities represent 90% of actual property and special franchise tax expenses above or below the rate allowance for future collection from or payment to the Company's customers.

Temporary state assessment: In June 2009, the NYPSC authorized utilities, including the Company, to recover the costs required for payment of the Temporary State Energy & Utility Service Conservation Assessment ("Temporary State Assessment"), including carrying charges. The Temporary State Assessment is subject to reconciliation over a five year period beginning July 1, 2009 and ending June 30, 2014. On June 18, 2014, the NYPSC issued an order authorizing certain utilities, including the Company, to recover the Temporary State Assessment subject to reconciliation, including carrying charges, from July 1, 2014 through June 30, 2017. As of May 31, 2014, the Company over-collected on these costs. The Company is required to net any deferred over-collection amounts against the amount to be collected in fiscal year 2014 and 2015 as well as the first payment relating to fiscal year 2015 and 2016.

Postretirement benefits: The amount in regulatory assets primarily represents the excess costs of the Company's pension and PBOP plans over amounts received in rates that are deferred to a regulatory asset to be recovered in future periods and the non-cash accrual of net actuarial gains and losses. Also included within this amount are certain pension deferral amounts from prior to the acquisition of KeySpan by NGUSA, which are being recovered in rates over a 10-year period ending August 2017, and the non-cash accrual of net actuarial gains and losses. The amount in regulatory liabilities primarily represents accrued carrying charges as calculated in accordance with the Company's pension and PBOP reserve mechanism.

Rate mitigation: The existing rate agreement provides for the establishment of a regulatory liability to be amortized through revenues for the deferral of amortization adjustments. The NYPSC recognized a negotiated five year revenue increase settlement, aggregating $625.7 million. As part of the NGUSA and KeySpan merger ("Grid merger") settlement these revenues were eliminated with rate mitigators. Of these mitigators, the NYPSC deferred recovery of certain deferred costs, reflected net synergy savings of the Grid merger, and modified the overall allowed rate of return. Amortization of the rate mitgator will continue during the stay out period at $2.0 million per year effective January 1, 2013 through December 31, 2014.

The Company records carrying charges on all regulatory balances for which cash expenditures have been made and are subject to recovery, or for which cash has been collected and is subject to refund, with the exception of derivative contracts and regulatory tax balances. Carrying charges are not recorded on items for which expenditures have not yet been made.

4. RATE MATTERS

General Rate Case

The Company has been subject to a rate plan with a primary term of five years (2008-2012), which remains in effect until modified by the NYPSC. Under this rate plan, base delivery rates include an allowed ROE of 9.8%.

Capital Investment

On June 13, 2014, the Company filed a petition with the NYPSC to implement a three-year capital investment program that would allow the Company to invest more than $700 million in gas infrastructure projects designed to enhance the safety and reliability of its gas systems and promote gas growth, while maintaining base delivery rates. The petition seeks (i) a new deferral mechanism that would permit the Company to defer for future recovery in rates the pre-tax revenue requirement associated with its capital spending program to the extent the amount of such investments exceeds the level of book depreciation expense reflected in the Company's rates; and (ii) the elimination of its existing City/State Construction and Non-Growth Related Capital deferral mechanisms. The Company has requested that the Commission grant this relief no later than September 2014.

Management Audit

In February 2011, the NYPSC selected Overland Consulting Inc., ("Overland") to perform a management audit of National Grid's affiliate cost allocations, policies and procedures. The Company disputed certain of Overland's final audit conclusions and the NYPSC ordered that further proceedings be conducted to address what, if any, ratemaking adjustments were necessary. On May 23, 2014, a Joint Proposal between National Grid and the Staff of the Department of Public Service was filed for NYPSC approval that resolves all financial and rate issues arising from or related to the audit, and an $11.4 million regulatory liability was recorded. At the time of the issuance of these financial statements, the NYPSC had yet to issue its approval.

Gas Management Audit

In February 2013, the NYPSC initiated a comprehensive management and operations audit of National Grid's New York gas businesses, including the Company, pursuant to the Public Service Law requirement that major electric and gas utilities undergo an audit every five years. The audit commenced in August 2013. At the time of the issuance of the financial statements, the Company cannot predict the outcome of this management and operations audit.

Operations Audit

In August 2013, the NYPSC initiated an operational audit to review the accuracy of the customer service, electric reliability, and gas safety data reported by the investor owned utilities operating in New York, including the Company. On December 19, 2013, the NYPSC selected Overland to conduct the audit, which commenced in February 2014. At the time of the issuance of these financial statements, the Company has not received the final audit findings and cannot predict the outcome of this 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
		(Revised)
	(in thousands of dollars)	
Plant and machinery	**$ 3,000,836**	$ 2,813,595
Land and buildings	**53,896**	55,880
Assets held for future use	**94**	-
Assets in construction	**79,434**	88,423
Software and other intangibles	**52,792**	24,149
Total property, plant and equipment	**3,187,052**	2,982,047
Accumulated depreciation and amortization	**(676,443)**	(623,676)
Property, plant and equipment, net	**$ 2,510,609**	$ 2,358,371

6. DERIVATIVE CONTRACTS

The Company utilizes derivative instruments, such as gas option contracts, gas swap contracts and gas purchase contracts, to manage commodity price risk associated with its natural gas purchases. The Company's risk management strategy is to reduce fluctuations in firm gas sales prices to its customers.

The Company's financial exposures are monitored and managed as an integral part of the Company's overall financial risk management policy. The Company engages in risk management activities, only in commodities and financial markets where it has an exposure to, and only in terms and volumes consistent with its core business.

Volumes

Volumes of outstanding commodity derivative contracts measured in dekatherms ("dths") are as follows:

	March 31,	
	2014	2013
	(in thousands)	
Gas purchase contracts (dths)	**37,743**	24,397
Gas swap contracts (dths)	**1,320**	5,540
Gas option contracts (dths)	**7,190**	1,450
Total	**46,253**	31,387

Amounts Recognized in the Accompanying Balance Sheets

	Asset Derivatives					Liability Derivatives			
	March 31,					March 31,			
	2014		2013			**2014**		2013	
	(in thousands of dollars)					*(in thousands of dollars)*			
Current assets:					**Current liabilities:**				
Rate recoverable contracts:					Rate recoverable contracts:				
Gas swap contracts	**$**	**497**	$	1,813	Gas swap contracts	**$**	**27**	$	10
Gas option contracts		**726**		422	Gas option contracts		**180**		4
Gas purchase contracts		**9,933**		12,026	Gas purchase contracts		**1,853**		335
		11,156		14,261			**2,060**		349
Non-current assets:					**Non-current liabilities:**				
Rate recoverable contracts:					Rate recoverable contracts:				
Gas purchase contracts		**11,199**		3,165	Gas purchase contracts		**1,266**		1,003
		11,199		3,165			**1,266**		1,003
Total	**$**	**22,355**	$	17,426	Total	**$**	**3,326**	$	1,352

The changes in fair value of the Company's rate recoverable contracts are offset by changes in regulatory assets and liabilities. As a result, the changes in fair value of those contracts had no impact in the accompanying statements of income. The Company had no derivative contracts not subject to rate recovery as of March 31, 2014 and 2013.

Credit and Collateral

The Company is exposed to credit risk related to transactions entered for commodity price risk management. Credit risk represents the risk of loss due to counterparty non-performance. Credit risk is managed by assessing each counterparty's credit profile and negotiating appropriate levels of collateral and credit support.

The credit policy for commodity transactions is managed and monitored by NGUSA's Executive Energy Risk Management Committee ("EERC"), which is responsible for approving risk management policies and objectives for risk assessment, control and valuation, and the monitoring and reporting of risk exposures. NGUSA's Energy Procurement Risk Management Committee ("EPRMC") is responsible for approving transaction strategies, annual supply plans, counterparty credit approval, as well as all valuation and control procedures. The EERC is chaired by the Global Tax and Treasury Director and reports to the Finance Committee. The EPRMC is chaired by the Vice President of U.S. Treasury and reports to the EERC.

The EPRMC monitors counterparty credit exposure and appropriate measures are taken to bring such exposures below the limits, including, without limitation, netting agreements, and limitations on the type and tenor of trades. The Company enters into enabling agreements that allow for payment netting with its counterparties, which reduce its exposure to counterparty risk by providing for the offset of amounts payable to the counterparty against amounts receivable from the counterparty. In instances where a counterparty's credit quality has declined, or credit exposure exceeds certain levels, the Company may limit its credit exposure by restricting new transactions with the counterparty, requiring additional collateral or credit support and negotiating the early termination of certain agreements. Similarly, the Company may be required to post collateral to its counterparties. The Company's credit exposure for all derivative instruments, applicable payables and receivables, net of collateral and instruments that are subject to master netting agreements, was $19.0 million and $16.0 million as of March 31, 2014 and 2013, respectively.

The aggregate fair value of the Company's derivative instruments with credit-risk-related contingent features that are in a liability position at March 31, 2014 and 2013 was $1.7 million and $0.05 million, respectively. The Company had no collateral posted for these instruments at March 31, 2014 or 2013, respectively. If the Company's credit rating were to be downgraded by one or two levels, it would not be required to post any additional collateral. If the Company's credit rating were to be downgraded by three levels, it would be required to post $1.9 million and zero additional collateral to its counterparties at March 31, 2014 and 2013, respectively.

Offsetting Information for Derivatives Subject to Master Netting Arrangements

March 31, 2014
Gross Amounts Not Offset in the Balance Sheets
(in thousands of dollars)

ASSETS: Description	Gross amounts of recognized assets *A*	Gross amounts offset in the Balance Sheets *B*	Net amounts of assets presented in the Balance Sheets *C=A+B*	Financial instruments *Da*	Cash collateral received *Db*	Net amount *E=C-D*
Commodity Derivatives						
Gas swap contracts	$ 497	$ -	$ 497	-		$ 497
Gas option contracts	726	-	726	-		726
Gas purchase contracts	21,132	-	21,132	-	-	21,132
Total	$ 22,355	$ -	$ 22,355	$ -	$ -	$ 22,355

LIABILITIES: Description	Gross amounts of recognized liabilities *A*	Gross amounts offset in the Balance Sheets *B*	Net amounts of liabilities presented in the Balance Sheets *C=A+B*	Financial instruments *Da*	Cash collateral paid *Db*	Net amount *E=C-D*
Commodity Derivatives						
Gas swap contracts	$ (27)	$ -	$ (27)	$ -		$ (27)
Gas option contracts	(180)	-	(180)	-		(180)
Gas purchase contracts	(3,119)	-	(3,119)	-	-	(3,119)
Total	$ (3,326)	$ -	$ (3,326)	$ -	$ -	$ (3,326)

March 31, 2013
Gross Amounts Not Offset in the Balance Sheets
(in thousands of dollars)

ASSETS: Description	Gross amounts of recognized assets *A*	Gross amounts offset in the Balance Sheets *B*	Net amounts of assets presented in the Balance Sheets *C=A+B*	Financial instruments *Da*	Cash collateral received *Db*	Net amount *E=C-D*
Commodity Derivatives						
Gas swap contracts	$ 1,813	$ -	$ 1,813	-		$ 1,813
Gas option contracts	422	-	422	-		422
Gas purchase contracts	15,191	-	15,191	-	-	15,191
Total	$ 17,426	$ -	$ 17,426	$ -	$ -	$ 17,426

LIABILITIES: Description	Gross amounts of recognized liabilities *A*	Gross amounts offset in the Balance Sheets *B*	Net amounts of liabilities presented in the Balance Sheets *C=A+B*	Financial instruments *Da*	Cash collateral paid *Db*	Net amount *E=C-D*
Commodity Derivatives						
Gas swap contracts	$ (10)	$ -	$ (10)	$ -		$ (10)
Gas option contracts	(4)	-	(4)	-		(4)
Gas purchase contracts	(1,338)	-	(1,338)	-	-	(1,338)
Total	$ (1,352)	$ -	$ (1,352)	$ -	$ -	$ (1,352)

7. FAIR VALUE MEASUREMENTS

The following tables present assets and liabilities 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:				
Derivative contracts				
Gas swap contracts	$ -	$ 497	$ -	$ 497
Gas option contracts	-	-	726	726
Gas purchase contracts	-	1,205	19,927	21,132
Total	-	1,702	20,653	22,355
Liabilities:				
Derivative contracts				
Gas swap contracts	-	27	-	27
Gas option contracts	-	-	180	180
Gas purchase contracts	-	273	2,846	3,119
Total	-	300	3,026	3,326
Net assets	$ -	$ 1,402	$ 17,627	$ 19,029

	March 31, 2013			
	Level 1	Level 2	Level 3	Total
		(in thousands of dollars)		
Assets:				
Derivative contracts				
Gas swap contracts	$ -	$ 1,813	$ -	$ 1,813
Gas option contracts	-	-	422	422
Gas purchase contracts	-	4	15,187	15,191
Total	-	1,817	15,609	17,426
Liabilities:				
Derivative contracts				
Gas swap contracts	-	10	-	10
Gas option contracts	-	-	4	4
Gas purchase contracts	-	47	1,291	1,338
Total	-	57	1,295	1,352
Net assets	$ -	$ 1,760	$ 14,314	$ 16,074

Derivative Contracts*:* The Company’s Level 2 fair value derivative instruments primarily consist of over-the-counter (“OTC”) gas swap contracts and gas purchase contracts with pricing inputs obtained from the New York Mercantile Exchange and Intercontinental Exchange (“ICE”), except in cases where the ICE publishes seasonal averages or where there were no transactions within the last seven days. The Company may utilize discounting based on quoted interest rate curves, including consideration of non-performance risk, and may include a liquidity reserve calculated based on bid/ask spread for the Company’s Level 2 derivative instruments. Substantially all of these price curves are observable in the marketplace throughout at least 95% of the remaining contractual quantity, or they could be constructed from market observable curves with correlation coefficients of 95% or higher.

The Company's Level 3 fair value derivative instruments primarily consist of OTC gas option and gas purchase contracts, which are valued based on internally-developed models. Industry-standard valuation techniques, such as the Black-Scholes pricing model, Monte Carlo simulation, and Financial Engineering Associates libraries are used for valuing such instruments. A derivative is designated Level 3 when it is valued based on a forward curve that is internally developed, extrapolated or derived from market observable curves with correlation coefficients less than 95%, where optionality is present, or if non-economic assumptions are made. The internally developed forward curves have a high level of correlation with Platts Mark-to-Market curves and are reviewed by the middle office. The Company considers non-performance risk and liquidity risk in the valuation of derivative contracts categorized in Level 2 and Level 3.

Changes in Level 3 Derivatives

	Years Ended March 31,	
	2014	**2013**
	(in thousands of dollars)	
Balance as of the beginning of the year	**$ 14,314**	$ 7,162
Total gains or losses included in regulatory assets and liabilities	**9,330**	2,523
Settlements	**(6,017)**	4,629
Balance as of the end of the year	**$ 17,627**	$ 14,314

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.

The following table provides information about the Company's Level 3 valuations:

Quantitative Information About Level 3 Derivatives

Commodity	Level 3 Position	Fair Value as of March 31, 2014			Valuation Technique(s)	Significant Unobservable Input	Range
		Assets	(Liabilities)	Total			
		(in thousands of dollars)					
Physical							
Gas	Gas purchase contracts	$ 16,880	$ (2,846)	$ 14,034	Discounted Cash flow	Forward Curve (A)	$2.709 - $14.056/dth
Gas	Cross commodity	3,047	-	3,047	Discounted Cash flow	Forward Curve	$43.19 - $84.28/dth
Financial							
Gas	Gas option contracts	726	(180)	546	Discounted Cash flow	Implied Volatility	29% - 31%
	Total	$ 20,653	$ (3,026)	$ 17,627			

(A) Includes deals with valuation assumptions on gas supply.

The significant unobservable inputs listed above would have a direct impact on the fair values of the Level 3 instruments if they were adjusted. The significant unobservable inputs used in the fair value measurement of the Company's gas purchase and gas option derivatives are forward commodity prices, both gas and electric, implied volatility and valuation assumptions pertaining to the peaking gas deals based on the forward gas curves. A relative change in commodity price at various locations underlying the open positions can result in significantly different fair value estimates.

Other Fair Value Measurements

The Company's balance sheets reflect long-term debt at amortized cost. The fair value of the Company's long-term debt was based on quoted market prices when available, or estimated using quoted market prices for similar debt. The fair value of this debt at March 31, 2014 and 2013 was $696.9 million and $744.1 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.

8. EMPLOYEE BENEFITS

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

The Pension Plans provide union employees, as well as all non-union employees hired before January 1, 2011, with a retirement benefit. Supplemental non-qualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives. The 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 the years ended March 31, 2014 and 2013, the Company made contributions of approximately $27.0 million and $29.1 million to the Plans.

Plan assets are commingled and cannot be specifically allocated to an individual company. The Plans' costs are first directly charged to the Company based on the Company's employees that participate in the Plans. Costs associated with affiliated service companies' employees are then allocated as part of the labor burden for work performed on the Company's behalf. In addition, certain changes in the funded status of the Plans are also allocated based on the employees associated with the Company through an intercompany payable account and are presented as postretirement benefits in the accompanying balance sheets. Pension and PBOP expense are included in operations and maintenance expense in the accompanying statements of income.

KeySpan's unfunded obligations at March 31, 2014 and 2013 are as follows:

	March 31,	
	2014	2013
	(in thousands of dollars)	
Pension	**$ 704,169**	$ 892,701
PBOP	**916,706**	1,339,788
	$ 1,620,875	$ 2,232,489

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	**$ 11,465**	$ 11,284
PBOP	**13,863**	13,877
	$ 25,328	$ 25,161

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 $0.3 million and $0.3 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 $2.9 million in the current fiscal year. At March 31, 2014 and 2013, the Company had accrued IBNR of $11.3 million and $17.2 million respectively.

9. CAPITALIZATION

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

(in thousands of dollars)	
Years Ending March 31,	
2015	$ -
2016	-
2017	100,000
2018	-
2019	-
Thereafter	500,000
Total	$ 600,000

Dividend Restrictions

Pursuant to the NYPSC’s orders, the ability of the Company to pay dividends to KeySpan is conditioned upon maintenance of a utility capital structure with debt not exceeding 58% of total utility capitalization. At March 31, 2014 and 2013, the Company was in compliance with this covenant. In accordance with the NYPSC order approving the acquisition of KeySpan, the Company is permitted to declare dividends to the extent of retained earnings accumulated since the date of acquisition plus unappropriated retained earnings, unappropriated undistributed earnings and accumulated other comprehensive income existing immediately prior to the date of acquisition. At the date of acquisition, the balance of retained earnings of the Company existing immediately prior of $478.6 million was reclassified into additional paid-in capital. In August 2012,

the Company issued a dividend in the amount of $250.0 million to the Parent which was settled via the money pool. Of the total $250.0 million dividend, $139.0 million has been issued from retained earnings, with the remainder from additional paid-in capital.

Preferred Stock

In connection with NGUSA's acquisition of KeySpan, the Company became subject to a requirement to issue a class of preferred stock having one share (the "Golden Share"), subordinate to any existing preferred stock. The holder of the Golden Share would have voting rights that limit the Company's right to commence any voluntary bankruptcy, liquidation, receivership or similar proceeding without the consent of the holder of the Golden Share. The NYPSC subsequently authorized the issuance of the Golden Share to a trustee, GSS Holdings, Inc. ("GSS"), who will hold the Golden Share subject to a Services and Indemnity Agreement requiring GSS to vote the Golden Share in the best interests of New York State. The Golden Share was issued by the Company on July 8, 2011. The Golden Share has a par value of $1 dollar.

10. INCOME TAXES

Components of Income Tax Expense

	Years Ended March 31,	
	2014	2013
	(in thousands of dollars)	
Current tax expense (benefit):		
Federal	**$ (11,684)**	$ (4,312)
State	**225**	3,612
Total current tax benefit	**(11,459)**	(700)
Deferred tax expense:		
Federal	**37,422**	30,296
State	**4,176**	5,098
Total deferred tax expense	**41,598**	35,394
Total income tax expense	**$ 30,139**	$ 34,694

Statutory Rate Reconciliation

The Company's effective tax rates for the years ended March 31, 2014 and 2013 are 38% and 42%, respectively. The following table presents a reconciliation of income tax expense at the federal statutory tax rate of 35% to the actual tax expense:

	Years Ended March 31,	
	2014	2013
	(in thousands of dollars)	
Computed tax at the statutory rate	**$ 27,855**	$ 29,229
Change in computed taxes resulting from:		
State income tax, net of federal benefit	**2,860**	5,662
Other items, net	**(576)**	(197)
Total	**2,284**	5,465
Federal and state income taxes	**$ 30,139**	$ 34,694

The Company is a member of 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, $3.0 million of deferred tax liabilities have been classified as current in the Company's Balance Sheets, representing the cumulative adjustment expected to be reflected in income for tax purposes during the twelve months ending March 31, 2015. The application of these regulations is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

On March 31, 2014, New York's legislature enacted as part of the 2014-15 budget package, legislation which included significant tax changes. For tax years beginning on or after January 1, 2016, the New York corporate franchise rate is reduced from 7.1% to 6.5%. Additionally, for tax years beginning on or after January 1, 2015, New York State will generally require combined reporting if the taxpayer is engaged in a unitary business and a 50% common ownership test is met. The Metropolitan Transportation Authority surcharge rate increased from 17% to 25.6% of the NY rate for taxable years beginning after 2014 and before 2016. For subsequent years, the rate is to be adjusted by the Commissioner of the New York State Department of Taxation and Finance. As of March 31, 2014, the Company remeasured its New York State deferred tax assets and liabilities based upon the enacted law that will apply when the corresponding state temporary differences are expected to be realized or settled. Specifically, the Company decreased its New York State deferred tax liability by $6.2 million with an offset to regulatory liabilities to reflect the decrease in tax rate. The application of this legislation is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Deferred Tax Components

	March 31,	
	2014	2013
	(in thousands of dollars)	
Deferred tax assets:		
Pensions, PBOP and other employee benefits	**$ 93,787**	$ 116,478
Regulatory liabilities - other	**80,908**	46,666
Future federal benefit on state taxes	**37,011**	41,334
Environmental reserve	**30,509**	47,306
Net operating losses	**22,866**	5,560
Other items	**12,110**	22,093
Total deferred tax assets [(1)]	**277,191**	279,437
Deferred tax liabilities:		
Property related differences	**707,928**	659,161
Regulatory assets - environmental	**123,644**	141,851
Regulatory assets - other	**93,841**	71,340
Other items	**21,170**	26,869
Total deferred tax liabilities	**946,583**	899,221
Net deferred income tax liabilities	**669,392**	619,784
Current portion of deferred income tax liabilities	**37,686**	27,262
Deferred income tax liabilities	**$ 631,706**	$ 592,522

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

During the year ended March 31, 2014, the Company changed its accounting policy for presentation of tax balances. The change in policy resulted in a reclassification of balances reported at March 31, 2013, which increased accounts receivable

from affiliates by $2.7 million, increased other current assets by $13.3 million, and increased other non-current liabilities by $16.0 million.

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)
03/31/2033	$	14,757
03/31/2034		68,099

Expiration of state net operating losses		NYS
		(in thousands of dollars)
03/31/2029	$	126,259
03/31/2030		30,845
03/31/2031		-
03/31/2032		22,450
03/31/2033		36,530
03/31/2034		89,802

Unrecognized Tax Benefits

As of March 31, 2014 and 2013, the Company's unrecognized tax benefits totaled $64.5 million and $102.9 million, respectively, of which $0.7 million and $10.3 million, respectively, would affect the effective tax rate, if recognized.

The following table presents changes to the Company's unrecognized tax benefits:

	Years Ended March 31,			
		2014		2013
	(in thousands of dollars)			
Balance as of the beginning of the year	**$**	**102,918**	$	92,618
Gross increases - tax positions in prior periods		**9,937**		2,364
Gross decreases - tax positions in prior periods		**(13,491)**		(421)
Gross increases - current period tax positions		**9,271**		10,769
Gross decreases - current period tax positions		**(12)**		(407)
Settlements with tax authorities		**(44,098)**		(2,005)
Balance as of the end of the year	**$**	**64,525**	$	102,918

As of March 31, 2014 and 2013, the Company has accrued for interest related to unrecognized tax benefits of $4.5 million and $10.7 million, respectively. During the years ended March 31, 2014 and 2013, the Company recorded a reduction to interest expense of $0.6 million and an increase in interest expense of $4.7 million, respectively. The Company recognizes accrued interest related to unrecognized tax benefits in other interest, including affiliated interest. Related penalties, if applicable, are recorded to other deductions, 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 twelve months that would cause the total amount of unrecognized tax benefits to increase or decrease. However, the Company does not believe any such increases or decreases would be material to its results of operations, financial position, or cash flows.

During the year ended March 31, 2014 the IRS has concluded its examination of the NGNA consolidated filing group's corporate income tax returns, which includes corporate income tax returns of Keyspan Corporation and subsidiaries for the short period ended August 24, 2007, and of NGNA and Subsidiaries for the periods ended March 31, 2008 and 2009. These examinations were completed on March 27, 2014 and March 31, 2014, respectively, with an agreement on the majority of income tax issues for the years referenced above, as well as an acknowledgment that certain discrete items remain disputed. NGNA is in the process of appealing the disputed issues with the IRS Office of Appeals. The Company does not anticipate a change in its unrecognized tax positions in the next twelve months as a result of the appeals. However, pursuant to the Company's tax sharing agreement, the audit or appeals may result in a change to allocated tax.

The years ended March 31, 2010 through March 31, 2014 remain subject to examination by the IRS.

The State of New York is in the process of examining the Company's NYS income tax returns for the years starting January 1, 2003 through March 31, 2008. The tax returns for the fiscal years ended March 31, 2009 through March 31, 2014 remain subject to examination by the State of New York. The Company has filed New York Investment Tax Credit claims for the tax years ended December 31, 2002 through March 31, 2010. New York State has disallowed the claims for December 31, 2002 through December 31, 2006 upon audit, and also denied them on appeal to the New York Tax Tribunal, which decision was further appealed to the Supreme Court, Appellate Division. On June 6, 2013, the Company received an adverse decision from the Supreme Court, Appellate Division, and made tax and interest payments of $10.5 million and $5.6 million, respectively, during the fiscal year.

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

Jurisdiction	Tax Year
Federal	August 24, 2007*
New York	December 31, 2003

*The KeySpan consolidated filing group for tax year ended August 24, 2007 and the NGNA consolidated filing group for fiscal years ending March 31, 2008 and 2009, are in the process of appealing certain disputed issues with the IRS Office of Appeals.

11. ENVIRONMENTAL MATTERS

The normal ongoing operations and historic activities of the Company are subject to various federal, state and local environmental laws and regulations. Under federal and state Superfund laws, potential liability for the historic contamination of property may be imposed on responsible parties jointly and severally, without regard to fault, even if the activities were lawful when they occurred.

The Company has identified numerous Manufactured Gas Plant (“MGP”) sites and related facilities, which were owned or operated by the Company or its predecessors. These former sites, some of which are no longer owned by the Company, have been identified to the NYPSC and the Department of Environmental Conservation (“DEC”) for inclusion on appropriate site inventories. Administrative Order on Consents (“ACO”) or Voluntary Cleanup Agreements have been executed with the DEC to address the investigation and remediation activities associated with certain sites. Expenditures incurred for the years ended March 31, 2014 and 2013 were $38.3 million and $35.5 million, respectively.

Upon the acquisition of KeySpan by NGUSA, the Company recognized environmental liabilities at fair value. The fair values included discounting of the reserve, which is being accreted over the period for which remediation is expected to occur.

The Company estimated the remaining costs of environmental remediation activities were $70.4 million and $108.4 million at March 31, 2014 and 2013, respectively. The Company’s environmental obligation is discounted at a rate of 6.5%; the undiscounted amount of environmental liabilities at March 31, 2014 and, 2013 was $87.8 million and $129.6 million, respectively. These costs are expected to be incurred over the next 40 years, and the discounted amounts have been recorded as liabilities in the accompanying balance sheets. However, remediation costs for each site may be materially higher than estimated, depending on changing technologies and regulatory standards, selected end use for each site, and

actual environmental conditions encountered. The Company has recovered amounts from certain insurers, and, where appropriate, the Company may seek recovery from other insurers and from other potentially responsible parties, but it is uncertain whether, and to what extent, such efforts will be successful.

By rate orders, the NYPSC has provided for the recovery of SIR costs. Accordingly, as of March 31, 2014 and 2013, the Company has recorded net environmental regulatory assets of $272.3 million and $324.4 million, respectively.

The Company believes that its ongoing operations, and its approach to addressing conditions at historic sites, are in substantial compliance with all applicable environmental laws, and that the obligations imposed on it because of the environmental laws will not have a material impact on its results of operations or financial position since, as noted above, environmental expenditures incurred by the Company are recoverable from customers.

12. COMMITMENTS AND CONTINGENCIES

The Company has long-term commitments with a variety of suppliers and pipelines to purchase gas supply, gas storage capability, and transportation of gas on interstate gas pipelines. The Company is liable for these payments regardless of the level of services required from third-parties.

The Company's commitments under these long-term contracts for the years subsequent to March 31, 2014 are as follows:

(in thousands of dollars)

Years Ending March 31,	Gas
2015	$ 342,928
2016	247,343
2017	233,143
2018	192,681
2019	157,904
Thereafter	601,960
Total	$ 1,775,959

Legal Matters

Several lawsuits have been filed that allege damages resulting from contamination associated with the historic operations of a former MGP located in Bay Shore. The Company has been conducting a remediation at Bay Shore pursuant to an ACO with the New York State DEC. The Company intends to contest each of the lawsuits vigorously.

The Company continues to pursue a number of refund claims with respect to garbage and other taxes levied on the Company by local authorities on Long Island, most significantly Nassau County.

In addition to the matters described above, the Company is subject to various legal proceedings 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.

SuperStorm Sandy

In October 2012, SuperStorm Sandy hit the northeastern U.S. affecting energy supply to customers in the Company's service territory. Total costs associated with gas customer service restoration from this storm (including capital expenditures) were approximately $135.0 million through March 31, 2014.

The Company has recorded an "other receivable" in the accompanying balance sheets in the amount of $39.0 million and $42.2 million as of March 31, 2014 and 2013, respectively, relating to claims filed against property damage and business

interruption insurance policies, net of insurance deductibles and allowances. As of March 31, 2014, NGUSA has received multiple advance payments from its insurers, of which $54.2 million has been allocated to KEDLI.

13. RELATED PARTY TRANSACTIONS

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 money pool. A summary of net outstanding amounts of accounts receivable from and accounts payable to affiliates 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)*	
KeySpan Corporation	**$ 27,279**	$ 48,119	**$ -**	$ -
Brooklyn Union Gas Company	**-**	-	**10,034**	45,238
NGUSA Service Company	**-**	-	**69,594**	50,523
Niagara Mohawk Power Corp	**-**	-	**1,085**	910
NG Electric Services LLC	**-**	-	**3,652**	6,914
Other	**1,411**	1,703	**1,747**	1,329
Total	**$ 28,690**	$ 49,822	**$ 86,112**	$ 104,914

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 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 borrowings of $551.6 million and $398.0 million at March 31, 2014 and 2013, respectively. The average interest rates for the intercompany money pool were 0.7% and 1.5% for the years ended March 31, 2014 and 2013, 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 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. Lastly, when a specific cost/causation principle is not determinable, 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 $253.4 million and $123.6 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 $4.2 million and $3.0 million before taxes, and $2.8 million and $2.0 million after taxes, for the years ended March 31, 2014 and 2013, respectively.