Company Number 2006000

Annual Report and Accounts 2007/08
National Grid Gas plc

Contents

Operating and Financial Review

Contents to Operating and Financial Review

This Operating and Financial Review describes the main trends and factors underlying our development, performance and position during the year ended 31 March 2008 as well as those likely to affect our future development, performance and position. It has been prepared in line with the guidance provided in the Reporting Statement on the Operating and Financial Review issued by the UK Accounting Standards Board.

Principal operations

We are part of the National Grid group of businesses. Our principal operations are the ownership and operation of regulated gas infrastructure networks and the provision of gas metering services in Great Britain. We also have an interest in liquefied natural gas (LNG) storage facilities in Great Britain.

The performances of our principal businesses are reported by segment, reflecting the management responsibilities and economic characteristics of each activity. Our principal businesses and segments, together with other activities and discontinued operations, are as follows:

Businesses and segments	Description of principal activities
Gas Transmission	The transmission of gas in the UK as owner and operator of the gas national transmission system in Great Britain and storage facilities for LNG.
Gas Distribution	The distribution of gas in England as the owner and operator of four of the UK's eight gas distribution networks.
Gas Metering	The provision of regulated gas metering and meter reading services in Great Britain.
Other activities	Other activities do not constitute a segment in their own right, but comprise the provision of transportation transaction services on behalf of all the major gas network transportation companies, including ourselves, together with corporate activities.
Discontinued operations	Businesses that we have exited and comprising the four gas distribution networks we sold in 2005.

History

National Grid Gas originated from the restructuring of the UK gas industry in 1986.

Key milestones	
1986	British Gas incorporated as a public limited company
1997	British Gas demerged Centrica
1999	Financial and restructuring programme completed leading to creation of a new parent company, BG Group, separation of the regulated Transco business from the other businesses of BG Group and the establishment of a financial ring-fence around Transco
2000	Lattice Group, including Transco, demerged from BG Group
2002	Merger of Lattice Group and National Grid Group to form National Grid Transco
2005	Sales of four UK regional gas distribution networks
2005	National Grid adopted as our brand name, with Transco renamed National Grid Gas

Vision, strategy and objectives

Vision

We are part of National Grid's vision to be the foremost international electricity and gas company, delivering unparalleled safety, efficiency and reliability, vital to the well-being of customers and communities. We are committed to being an innovative leader in energy management and to safeguarding our global environment for future generations.

Strategy

National Grid's strategy is based on focus, integration and discipline as follows:

Focus	We are focused on a clear business model based on the ownership and operation of large scale asset intensive businesses within our principal growth market of gas infrastructure in the UK.
Integration	We aim to run our businesses in an integrated way – organising our activities along lines of business, supported by effective and efficient shared services and information systems. This involves deploying proven processes, common systems and best practices within each business, supported by common operating principles, and safety and environmental standards, seeking to maximise the competitive advantages that come from being part of an international organisation, balanced with the need to provide excellent service to customers and to maintain and build local relationships with other key stakeholders.
Discipline	We aim to be disciplined in the application of best practice, increasingly standardising our approach in the way we operate and finance our activities. Our aim is for rigorous financial discipline, ensuring that we have the capital we need to grow, while maintaining the investor confidence that comes from a disciplined approach to our balance sheet.

Objectives

Building on National Grid's strategy, we have set ourselves objectives to deliver National Grid's vision of becoming the foremost international electricity and gas company. By achieving our objectives we aim to deliver sustainable growth and so create value for National Grid's shareholders.

Delivering National Grid's strategy	– Create lines of business – Build operating model – common systems and processes, sharing best practice
Operating performance	– Improve safety – Improve efficiency – Improve reliability – Improve customer service – Deliver our capital investment plans
Talent	– Identify and develop talent and skills – Improve engagement and performance – Enhance inclusion and diversity
Relationships	– Help investors understand our value – Improve relationships with customers, regulators and governments – Work effectively with suppliers – Deepen our involvement with communities
Environment	– Lead on climate change – Manage and remediate contaminated land – Protect the environment – Be efficient in our use of natural resources
Financial performance	– Increase profits – Obtain appropriate returns on our investments – Maintain financial discipline

This strategy is underpinned by our commitment to corporate responsibility, including the core values that we expect our management and employees to operate by.

Responsibility	– Operate to the highest standards of corporate governance – Conduct our business in a lawful and ethical manner – Live our core values of: ● Respect others and value diversity ● Take ownership for driving performance ● Demonstrate integrity and openness in all relationships ● Work together as one team

We describe what these objectives mean, how we plan to achieve them and the progress we have made this year, in the performance summary and performance against our objectives sections of this Operating and Financial Review on pages 9 to 18.

Business drivers, risks and opportunities

Business drivers

Our principal activities include the operation of highly complex gas infrastructure networks. As a consequence, there are many factors that influence the financial returns we obtain.

We consider the following to be our principal business drivers:

Price controls	The prices we charge for use of our gas transmission and distribution networks are determined in accordance with regulator approved price controls. The negotiation of these arrangements has a significant impact on our revenues. Their duration is significant in providing stability to our operations, allowing us to plan ahead and invest in the confidence that we will obtain financial returns. Our price controls contain incentive and/or penalty arrangements that can affect us financially based on agreed performance targets.
Multi-year contracts	Revenues from metering services are largely determined by contractual arrangements, which are long-term and with 'blue chip' customers.
Safety, efficiency and reliability	Our ability to operate safely and reliably is of paramount importance to us, our employees, our contractors, our customers, our regulators and the communities we serve. Our financial performance is affected by our performance in these areas. Our objective is to deliver services as efficiently as possible. This allows us to limit price increases or to reduce prices to our customers and improve our own financial performance to the benefit of National Grid's shareholders.
Customer service	The quality of the service we deliver to customers, and the experiences that they have in dealing with us, whether through routine interactions or when problems arise, is important as it feeds through to the attitudes of regulators and is also linked to our financial performance.
Capital investment	Capital investment is a significant driver for organic growth. In our regulated gas networks, the prices we charge include an allowed return for capital investment determined in accordance with our price controls. These provide incentives for us to enhance the quality and reach of our networks through capital improvements. For other businesses, our capital investment in new assets allows us to increase or maintain revenues.
Relationships and responsibility	Our reputation is vitally important to us. Delivering sustainable value depends on the trust and confidence of our stakeholders and this can only be earned by conducting our business in a responsible manner.

A number of other factors also affect our financial performance, but are either less significant than our principal business drivers, or are mitigated by the way our operations are structured:

Weather and volumes	Changes in the quantities of gas delivered through our transmission and distribution networks may result in an increase or decrease in our revenues. Volumes are affected by weather and consumer demand as well as other factors. The impact of changing volumes may sometimes be offset by changes in costs or may sometimes result in an under- or over-recovery against our allowable revenues, with a corresponding increase or decrease in revenue in future periods.
Seasonality	Our current price control arrangements for gas transmission and distribution networks mean that revenues are less weighted towards the winter months than previously. Seasonality does not have a significant impact on our other revenues. With the exception of commodity costs, our operating costs are generally not seasonal.
Commodity and other pass-through costs	We are allowed to recover commodity costs and certain other direct costs through charges to customers. The timing of recovery of these costs can vary between financial periods leading to an under or over-recovery within any particular financial period. We are affected by commodity prices to the extent that they affect our own energy requirements, most significantly gas purchases for the operation of our gas transmission and gas distribution networks.
Inflation	Without action to improve efficiency, our operating costs increase each year as a result of wage increases and inflation in external costs. In general, our revenues also increase each year, although not necessarily at the same rate, depending on our regulatory or contractual arrangements. As a consequence, our ability to control costs and improve efficiency is important to our ability to increase operating profits. Our price controls are linked to retail price inflation, as is a proportion of our borrowings.
Interest rates	The costs of financing our operations are affected by changes in prevailing interest rates, as some of our debt is at floating rates. We hedge some of our exposure to interest rates with fixed-rate debt and derivative financial instruments to maintain a proportion of our debt at fixed interest rates.

Risks and opportunities

Risks and opportunities

We believe that the principal opportunities we have to contribute to the achievement of National Grid's vision and to the delivery of growth in value for its shareholders have been identified in National Grid's strategy and our objectives.

Conversely, we risk a shortfall in this contribution if we do not fulfil National Grid's strategy or if we fail to achieve our objectives.

Delivering National Grid's strategy	We believe that by implementing National Grid's strategy and transforming our businesses, we will be able to deliver increased value for National Grid's shareholders. Conversely, if we do not achieve this transformation, or the benefits in efficiency and effectiveness are not achieved, then our contribution to shareholder value will not grow as we hope or will diminish.
Operating performance	The operating profits and cash flows we generate are dependent on our operating performance – operating safely, efficiently and reliably and providing a quality service to customers. Our future growth is dependent on the delivery of our capital investment plans.
Talent	The skills and talents of our employees, and their motivation and dedication, are critical to the achievement of our objectives. Failure to develop our existing employees or to attract and recruit talented new employees could hamper our ability to deliver in the future.
Relationships	Our relationships with our stakeholders are critical to our future success. Maintaining these good relationships is dependent on our focusing on the areas that are important to them, such as the quality of service we provide to customers, the quality of information we provide to regulators and the way we address the concerns of, and interact with, all our stakeholders.
Environment	Safeguarding our global environment for future generations is dependent on integrating sustainability and climate change considerations into our business decisions, influencing legislators and regulators to reshape energy markets to meet the climate change challenge and helping and supporting our employees, customer and suppliers in changing their behaviour to be more considerate of the environment.
Financial performance	Strong financial performance and operating cash flows are the basis for funding our future capital investment programmes, for servicing our borrowings and paying dividends, as well as in increasing our value to National Grid's shareholders.
Responsibility	Strong corporate governance is essential to operating responsibly and the achievement of all our objectives. Our reputation as a responsible business is dependent on our ensuring all our behaviours are lawful and ethical, on complying with our policies and licences and on living up to our core values. If we do not live up to these high standards we could be exposed to adverse financial or other consequences.

We set out how we intend to achieve our objectives and the progress we have made during the year against our objectives on pages 10 to 18.

Risk management

Our approach to risk management is described in the principal risks and uncertainties section of this Operating and Financial Review on pages 7 and 8. In addition, information on how we have addressed certain of our financial risks is included in the financial position and financial management section of this Operating and Financial Review on pages 28 and 29.

Risk factors

Through our risk management process, we have identified a number of significant risks and uncertainties in achieving our objectives as follows:

- changes in law or regulation;
- breaches of environmental or health and safety law or regulations;
- network failure or inability to carry out critical non-network operations;
- achievement of business performance objectives, including regulatory targets and delivering anticipated cost and efficiency savings;
- regulatory treatment of commodity costs passed through to consumers;
- reputation damage from disruptions to supply, even if outside our control;
- fluctuations in interest rates and their impact on borrowings and derivatives;
- restrictions in borrowings, adverse changes in the global credit markets and changes in credit ratings or in tax rates;
- future funding requirements of our pension schemes; and
- changes in accounting standards.

Not all of these factors are within our control and, in addition, there may be other factors besides those listed that may have an adverse effect on National Grid Gas.

These risk factors are described in more detail in the principal risks and uncertainties section of this Operating and Financial Review on pages 7 and 8.

External market and regulatory environment

Markets in which we operate

The principal market in which we operate is the natural gas market in the UK.

The supply of natural gas in the UK is competitive in that consumers can contract with different suppliers to obtain the gas they need. Those suppliers are then responsible for sourcing that gas from gas extractors or importers as appropriate, as well as arranging for that gas to be delivered through physical delivery networks. These networks, including the ones we operate, are monopolies in their local areas as, for the majority of consumers, there are no alternative methods of receiving natural gas.

Natural gas delivery in the UK

Natural gas is transported through the gas national transmission system to regional gas distribution networks that then deliver gas to consumers on behalf of suppliers. Certain end customers, primarily large industrial users, receive gas direct from the national transmission system.

We are the owner and operator of the gas national transmission system and of four of the eight regional gas distribution networks in Great Britain. We charge gas shippers for our services, which they then incorporate into the prices charged to end consumers.

The gas distribution networks in Scotland and southern England are owned by Scotia Gas Networks, in the north of England by Northern Gas Networks, and in Wales and the west of England by Wales & West Utilities.

Other markets in which we operate

We also operate in gas related markets in Great Britain which are directly connected to our regulated businesses described above. Our regulated metering business owns approximately 80% of the domestic gas meters in Great Britain, although as the competitive market for metering services expands, this portfolio of gas meters will decline as our gas meters are displaced. We also participate in the competitive market for the provision of LNG storage services in Great Britain.

Regulation

As a result of our position in, and importance to, the UK economy, our gas transmission and distribution businesses are subject to UK and European Union laws and regulations.

Our businesses are also subject to safety legislation which is enforced by the Health and Safety Executive (HSE). Our gas operations work under a permissioning regime, whereby our organisation, processes and procedures are documented in safety cases that are subject to acceptance by the HSE.

Economic regulation of our businesses is undertaken by the Office of Gas and Electricity Markets (Ofgem). Ofgem operates under the direction and governance of the Gas and Electricity Markets Authority and has established price control mechanisms that restrict the amount of revenue that can be earned by regulated businesses.

We have six price controls, comprising two for our gas transmission operations and one for each of our four regional gas distribution networks. These price controls provide a financial incentive to invest, as we receive a return on efficiently incurred capital expenditure increasing our regulatory asset base, and also provide incentives by which we can gain or lose for our performance in managing system operation, and controlling internal costs, pass-through costs and service quality.

The current price control period for our gas transmission operations commenced on 1 April 2007 and is planned to last until 31 March 2012. The last price control period for our gas distribution operations ended on 31 March 2008 and a new price control period commenced on 1 April 2008, which is expected to last until 31 March 2013.

More information about the regulatory environment in which we operate, and on the nature of our price controls, is provided in the business discussions on pages 18 to 26.

In addition, as a public company with securities listed on the London Stock Exchange and on the New York Stock Exchange, we are subject to regulation by the UK Financial Services Authority and by the US Securities and Exchange Commission.

Current and future developments

External market developments

Market structure and ownership

There have been no significant changes in the structure of the UK gas infrastructure market since 2005, when we sold four of our regional gas distribution networks to other operators.

Energy market developments

High energy prices have been a key feature in the UK market during the last 12 months and this has led to significant increases in bills to consumers for their energy supplies.

The UK continues to be in a period of changing energy supply patterns, as the decline in UK continental shelf gas reserve means more reliance is placed on imported gas for both consumption and use in power generation. As a consequence of the decline in gas production from the UK continental shelf, our latest forecast is that the UK will import around 50% of its gas requirements by the end of the decade.

These changes are impacting our gas networks with significant investment underway and planned to link gas import facilities with domestic, business and industrial consumers.

Activity to increase the UK's import capability has involved the development of new import infrastructure by National Grid and other market participants. During the year, a number of significant infrastructure projects were commissioned, including a major gas pipeline in south Wales, linking the Milford Haven LNG import terminal to our gas network.

Regulatory developments

During the year ended 31 March 2008, there were no significant changes in the legislative and regulatory framework in the UK.

In September 2007, the European Commission published a third package of legislative proposals for energy markets within the European Union. The key areas include unbundling of transmission and distribution of energy from customer supply and generation activities, the creation of a European regulatory agency for energy and the establishment of a European network of transmission system operators for gas and electricity respectively, to facilitate cooperation and coordination at both a European and regional level. While there are many complex issues for which resolution is required, there is a strong desire for political agreement to be reached during 2008.

This was complemented in January 2008 by a number of environmental proposals focusing on renewable energy, emissions trading, carbon capture and energy efficiency.

In April 2008, Ofgem announced a review into the operation of the energy markets in the UK and how the regulatory model in the UK is functioning.

Changes in price controls

A five year price control for our gas transmission network came into operation on 1 April 2007, together with a one year system operator price control. We have also accepted system operator price controls for our gas transmission operations for 2008/09.

Our four gas distribution networks were subject to a one year price control review during 2007/08 and we have also accepted Ofgem's final proposals for new price controls covering the period from 1 April 2008 to 31 March 2013.

Further details of these price controls are provided in the business discussion sections: Gas Transmission, page 19 and Gas Distribution page 21.

Legal and related matters

Metering competition investigation

On 25 February 2008, Ofgem announced it had decided we had breached the Competition Act 1998 with respect to the development of term contracts with gas suppliers entered into by our metering services business in 2004 and imposed a fine of £41.6 million, which has been suspended pending our appeal to the Competition Appeal Tribunal. We believe that we have never been anti-competitive and that we will be successful in appealing this decision. We have therefore not provided for this fine in our financial statements.

Environmental remediation

In last year's Annual Report and Accounts we noted that we, together with the Environment Agency, had sought judicial review to clarify the legal position with regard to the remediation of a site in Bawtry, Yorkshire. This former gas site was not part of the assets that formed part of the gas privatisation in 1986 and therefore had never been owned by National Grid Gas. In June 2007, the House of Lords announced that it was allowing our appeal, confirming that National Grid Gas has no legal liability with respect to the site in Bawtry, nor for other former UK gas sites which did not form part of the assets we acquired at the time of privatisation.

Principal risks and uncertainties

Risk management

Understanding and managing risks is integral to the way we run our business. We have a well established risk management process that ensures risks are consistently assessed, recorded and reported in a visible, structured and continuous manner, the outputs of which are primarily used as a management tool. A secondary and natural output from this process is information that provides assurance to management at all levels and thus helps safeguard our assets and reputation. It has been designed to manage rather than eliminate material risks to the achievement of our strategic and business objectives, while also recognising that any such process can provide only reasonable, and not absolute, assurance against material misstatement or loss.

Principal risk factors

Our risk management process has identified the following principal risk factors which could have a material adverse effect on our business, financial condition, results of operations and reputation, as well as the value and liquidity of our securities. Not all of these factors are within our control. In addition, other factors besides those listed below may have an adverse effect on National Grid Gas. These risk factors should be read in conjunction with the rest of this Operating and Financial Review.

Changes in law or regulation

Our principal businesses are subject to regulation by the UK Government and other authorities such as Ofgem. Consequently, changes in law or regulation could adversely affect us. Regulatory decisions concerning, for example, whether licences or approvals to operate are granted or are renewed, whether there has been any breach of the terms of a licence or approval, recovery of incurred expenditure and the level of permitted revenues for our businesses, could have an adverse impact on our results of operations, cash flows, the financial condition of our businesses and the ability to develop those businesses in the future.

Breaches of environmental or health and safety law or regulations

The transmission and distribution of natural gas is potentially dangerous. We also use or generate in our operations hazardous and potentially hazardous products and by-products. We are subject to laws and regulations relating to pollution, the protection of the environment, and how we use and dispose of hazardous substances and waste materials. These expose us to costs and liabilities relating to our operations and our properties whether current, including those inherited from predecessor bodies, or formerly owned by us. We are also subject to laws and regulations governing health and safety matters protecting the public and our employees.

We commit significant expenditure toward complying with these laws and regulations. If additional requirements are imposed or our ability to recover these costs changes, this could have a material impact on our businesses and our results of operations and financial position. Any breach of these obligations, or even incidents that do not amount to a breach, could adversely affect our results of operations and our reputation.

For further information about environmental and health and safety matters in National Grid, see the 'Our Responsibility' section of National Grid's website at www.nationalgrid.com.

Network failure or the inability to carry out critical non-network operations

We may suffer a major network failure or may not be able to carry out critical non-network operations. Operational performance could be adversely affected by a failure to maintain the health of the system or network, inadequate forecasting of demand or inadequate record keeping. This could cause us to fail to meet agreed standards of service or be in breach of a licence or approval, and even incidents that do not amount to a breach could result in adverse regulatory and financial consequences, as well as harming our reputation.

In addition to these risks, we may be affected by other potential events that are largely outside of our control such as the impact of weather or unlawful acts of third parties. Weather conditions can affect financial performance and severe weather that damages infrastructure will adversely affect operational and potentially business performance and our reputation. Terrorist attack, sabotage or other intentional acts may also physically damage our assets or otherwise significantly affect corporate activities and as a consequence have an adverse impact on the results of operations.

Achievement of business performance objectives, including regulatory targets and delivering anticipated cost and efficiency savings

Earnings maintenance and growth from our regulated gas businesses will be affected by our ability to meet or exceed efficiency targets and service quality standards set by or agreed with Ofgem. In addition, from time to time, we publish cost and efficiency savings targets for our businesses. We have also substantially completed reorganising our operations along lines of business. To meet these targets and standards, we must continue to improve operational performance, service reliability and customer service. If we do not meet these targets and standards, or we do not complete implementation of this reorganisation as envisaged, we may not achieve the expected benefits, our business may be adversely affected and our performance, results of operations and our reputation may be harmed.

Regulatory treatment of commodity costs passed through to consumers
Changes in commodity prices could potentially impact our gas transmission and distribution businesses. Current regulatory arrangements provide the ability to pass-through virtually all of the increased costs related to commodity prices to consumers. However, if Ofgem were to restrict this ability, it could have an adverse effect on our operating results.

Reputation damage from disruptions to supply, even if outside our control
Our gas transmission and distribution businesses are responsible for transporting available gas. We consult with and provide information to regulators, governments and industry participants about future demand and the availability of supply. However, where there is insufficient supply, our role is to manage the relevant network safely, which in extreme circumstances may require us to disconnect consumers, which may damage our reputation.

Fluctuations in interest rates and their impact on borrowings and derivatives
Our results of operations may be affected because a significant proportion of our borrowings and derivative financial instruments are affected by changes in interest rates.

Restrictions in borrowings, adverse changes in the global credit markets and changes in credit ratings or in tax rates
We are subject to certain covenants and restrictions in relation to our listed debt securities and our bank lending facilities. We are also subject to restrictions on financing which have been imposed by regulators. These restrictions may hinder us in servicing the financial requirements of our businesses. Some of our debt is rated by credit rating agencies and changes to these ratings may affect both our borrowing capacity and the cost of those borrowings. Our borrowing capacity and cost of borrowing could also be affected by adverse changes in the global credit markets. The effective rate of tax we pay may be influenced by a number of factors including changes in law and accounting standards, the results of which could increase that rate.

Future funding requirements of pension schemes
Substantially all of our employees are members of a defined benefit pension scheme where the scheme assets are held independently of our own financial resources. Estimates of the amount and timing of future funding for the scheme are based on various actuarial assumptions and other factors including, among other things, the actual and projected market performance of the scheme assets, future long-term bond yields, average life expectancies and relevant legal requirements. The impact of these assumptions and other factors may result in a requirement for us to make additional contributions to the pension scheme. Our legal obligations to the scheme are limited to paying the employers' contribution rate set by the trustees of the scheme. However, circumstances may require that we make additional contributions. To the extent that any increases in contributions are not recoverable under our price controls, our results of operations could be adversely affected.

Changes in accounting standards
The accounting treatment under International Financial Reporting Standards (IFRS), as adopted by the European Union, of replacement expenditure, pensions and derivative financial instruments significantly affect the way we report our financial position and results of operations. As a body of practice develops for IFRS, the application and interpretation of accounting principles to our circumstances, and to those areas in particular, could result in changes in the financial results and financial position that we report. In addition, new standards, rules or interpretations may be issued which could also have significant effects.

Performance summary and key performance indicators

Delivering National Grid's strategy	**Lines of business**	● Integrated our Gas Transmission and Gas Distribution businesses into National Grid's global Transmission and Gas Distribution lines of business, each with a common management team and responsible Executive Director ● Progressed separation of functions and processes that support multiple lines of business		
	Operating model	● Commenced implementation of a new back office system ● Commenced reviews within each line of business, shared services and information services to identify best practices, so that they can be shared across National Grid		
Operating performance	**Safety**	Injuries to the public	2007/08: 26 2006/07: 20	Target: zero
		Employee LTI frequency rate	2007/08: 0.14 2006/07: 0.18	Target: zero
		Employee sickness absence rate	2007/08: 2.18% 2006/07: 2.20%	Target: zero work-related absences
		Gas Distribution mains replacement	2007/08: 1,850 km 2006/07: 1,850 km	Target: 1,835 km in 2007/08
	Reliability	Gas Transmission network reliability	2007/08: 100% 2006/07: 100%	Target: 100%
		Gas Distribution network reliability	2007/08: 99.999% 2006/07: 99.999%	Target: 99.999%
	Efficiency	Cost reduction programmes undertaken in Gas Transmission and Gas Distribution		
	Capital investment	Total capital investment	2007/08: £1,393 million 2006/07: £1,200 million	
Talent	**Talent, skills, engagement and performance**	● Our Directors and senior managers have been through our Performance for Growth programme, focusing on how to develop our employees, address skills gaps, increase employee engagement and coach for better performance ● We have developed and calibrated a single set of performance measures for our senior managers ● We have upgraded and aligned our talent review process across our businesses		
	Inclusion and diversity	Percentage of female employees	2007/08: 24.5% 2006/07: 20.0%	
		Percentage of black and minority ethnic employees	2007/08: 5.8% 2006/07: 4.5%	
Relationships	**Stakeholder relations and community involvement**	Participated in presentations to debt investors		
Environment	**Climate change**	Percentage reduction in greenhouse gas emissions	2007/08: 3% 2006/07: 9%	Target: year on year reduction
	Protecting the environment	Significant direct environmental incidents	2007/08: 26 2006/07: 16	Target: zero
		Total value of fines from prosecutions	2007/08: Zero 2006/07: Zero	Target: zero
Financial performance	**Profit and cash flow**	Adjusted operating profit*	2007/08: £994 million 2006/07: £792 million	
		Cash generated by continuing operations	2007/08: £1,555 million 2006/07: £1,407 million	
	Returns from investment	Gas transmission return on investment	2007/08: 7.2% 2006/07: 7.3%	
		Gas distribution return on investment	2007/08: 5.1% 2006/07: 5.0%	
	Financial discipline	Adjusted gearing ratio**	2008: 44% 2007: 40%	

* Adjusted operating profit excludes exceptional items and remeasurements.

** For the adjusted gearing ratio our gas transmission and distribution assets are measured at their regulatory value.

Performance against our objectives

Our performance and the progress we have made against our objectives are described below and on the following pages. This includes commentary on our financial results on pages 14 to 18 and more information on the performance and financial results of each business is included in the business sections on pages 18 to 26.

We measure the achievement of our objectives through the use of qualitative assessments and through the monitoring of quantitative indicators, called key performance indicators (KPIs). In line with our operating objectives, we use both financial and non-financial KPIs. Where relevant, KPIs are used as our primary measures of whether we are achieving our objectives. However, the scale and size of our operations mean we use many other detailed performance measures in addition to KPIs. We also use KPIs to measure performance against our primary objective of growing our businesses to create value for National Grid's shareholders. We use qualitative assessments to judge progress against our objectives in areas where numerical measures are less relevant.

This year, we have included adjusted gearing ratio as one of the KPIs measuring our financial performance. Our other KPIs are unchanged from last year.

Responsibility

We believe operating responsibly is essential to the way we conduct our operations, invest, develop our people and manage our relationships. It underpins everything we do.

We always strive to operate to the highest standards of corporate governance and we believe in strong business ethics, based around National Grid's Framework for Responsible Business and our core values of respecting others and valuing diversity, demonstrating integrity and openness in all relationships, taking ownership for driving performance and operating as one team.

The approach to corporate governance and business ethics within National Grid is described in more detail in the Corporate Governance section on pages 88 to 97 of National Grid's Annual Report 2007/08.

Delivering National Grid's strategy

We are in the process of transforming our businesses in line with National Grid's strategy. This means creating global lines of business across National Grid and focusing on delivering an improved service to our customers, supported by an operating model that delivers effective and efficient shared services and information systems.

Operating model	National Grid's operating model is based on ensuring that activities are carried out at the most appropriate level, either locally, within lines of business or across National Grid.

Lines of business
Our Gas Transmission and Gas Distribution businesses have been integrated into National Grid's global Transmission and Gas Distribution businesses, each led by an Executive Director of National Grid.

Common functions
Our businesses are already supported by a UK shared services function and National Grid has now combined the information services, procurement and legal services functions which serve our businesses in the UK, with the equivalent US functions, creating single functions that span National Grid, to ensure that there is a common operating approach.

Common systems and processes
National Grid's aim is to reduce the number of systems that it has and to align processes so that there is a single National Grid method of operating. In support of this aim, we have implemented a new back office system, which will underpin the development of common processes and integrate with front office systems used by our businesses.

While National Grid is centralising activities that it believes are common across National Grid, we remain focused on ensuring that our employees are able to deliver services to our customers locally.

Identification of best practice
Reviews have commenced within each line of business, shared services, information services and other functions to identify best practices, so that they can be shared across National Grid.

Safety, health and environmental management
Our transformation programme includes restructuring our approach to managing safety, health and environmental issues, embedding responsibility directly into the business for safety, health and environmental, supported by safety, health and environmental expertise in support functions. This means that all of our managers will be accountable for safety, health and environmental management in their areas of operations.

Operating performance

We aim for operational excellence by performing to the highest standards of safety, efficiency, and reliability and by improving customer service. By delivering on our capital investment plans we can create value through organic growth.

Safety	Safety is paramount. Our most important goals are: to ensure that members of the public are not injured as a direct result of our operations; to deliver a working environment where there are zero work-related injuries and illness; to reduce gas leaks on our distribution networks; and to improve the health of our employees so they are fit for work every day.
	We use a range of lagging and leading indicators to measure our performance against our safety objectives, including: members of the public injured as a direct result of our operations; employee lost time injury frequency rate; achievement of gas safety service standards; kilometres of gas distribution mains replaced; and employee sickness absence rate.

During 2007/08, we have reviewed the critical safety risks across our business, ensuring they are effectively managed. To support this, we have implemented National Grid's programme for improving safety performance, 'Trusted to Work Responsibly'. This renewed approach builds upon our well established safety procedures and reinforces the need for individual and collective ownership of safety performance. It recognises that our workforce is well trained and should be trusted to deliver their work in the right way – the safe way. It was launched across National Grid in October 2007 and followed by the publication and implementation of Golden Rules that encompass all our businesses. These set consistent standards for good safety behaviours, but are interpreted so that they reflect the risk profiles of different parts of the business and reinforce a culture whereby safety becomes second nature.

We have also reinforced our approach to process safety. During 2007/08, we have reviewed the risk profile of our assets and have completed a culture survey to find out the views of employees on process safety. We have also trained our Directors and senior managers in process safety and issued a new commitment statement agreed by the Board of National Grid.

Public safety

During 2007/08, 26 members of the public were injured as a result of our operations compared with 20 during 2006/07 and a target of zero.

Gas safety

We discuss gas safety in the Gas Distribution section on page 22.

Employee safety

During 2007/08, 21 of our employees received injuries that resulted in them taking time off work, compared with 29 in 2006/07 and a target of zero.

Employee lost time injuries track our progress towards our target of zero work-related injuries. However, our employee lost time injury frequency rate provides a more accurate indicator of year-on-year performance as it takes into account changing employee numbers. Employee lost time injuries per 100,000 hours worked was 0.14 in 2007/08 compared with 0.18 in the previous year.

Employee health

We are committed to protecting employees' health during work activities. We have continued to develop our risk based approach and instigated further programmes of support for employees with musculoskeletal conditions. Across the business, employees have engaged in well-being and education programmes designed to encourage good lifestyle choices. Approaches to health promotion are currently being reviewed with the aim of establishing and delivering an effective well-being programme, encompassing health education, fitness and nutrition, work/life balance, and health management and disease prevention.

Around 2.18% of available work days were lost due to sickness absence in 2007/08, compared with 2.20% in 2006/07.

Contractor safety

There was a decrease in contractor lost time injuries from 46 in 2006/07 to 36 in 2007/08.

Efficiency	By improving efficiency, we can constrain the cost of our operations borne by customers and improve returns to National Grid's shareholders. We review our operations continually to identify opportunities to improve the operational productivity of our assets and our people, and to identify areas in which we can reduce costs or restrict cost increases. Planning ahead is essential in our approach to maintaining and improving efficiency.
	Our primary method of measuring improvements in efficiency is through our financial performance.

We have continued to transform National Grid Gas in line with National Grid's strategy of being more focused, more integrated and more disciplined.

Information on our financial performance during the year is set out on pages 14 to 18.

Reliability	Our principal operations are critical to the functioning of the UK economy. The reliability of our gas networks is one of our highest priorities after safety.
	We use business-specific reliability performance indicators to measure our reliability performance.

Our approach to maintaining and improving reliability involves: investing in infrastructure and systems to provide the operational tools and techniques necessary to manage our assets and operations to high standards and investing in the renewal of assets; investing in the skills and capabilities of our people to give them the ability to operate our networks to a high degree of service excellence; and maintaining a constant focus on reliability as one of our principal objectives, ensuring we are proactive about planning to ensure reliability and that we react quickly to factors that could compromise reliability.

Information on the reliability of each of our businesses is discussed in the business sections on pages 19, 22 and 25.

Customer service	Our objective is to impress our customers with the quality of the services we provide, with our responsiveness when things go wrong and with our dedication to continued improvement.
	We use business-specific service quality KPIs to measure our performance in this area.

We plan to improve the way we interact with our customers by enhancing or replacing the systems we use, providing our employees with the training, empowerment and support they need to deliver, and by improving the quality of our internal and customer communications.

Information on the customer service performance of each of our businesses is discussed in the business sections on pages 20, 22 and 25.

Capital investment	Capital investment is one of the principal drivers of future growth, as the majority of the capital investment we make enables us to earn an increased financial return.
	The principal measure we use to monitor organic investment is capital expenditure, which includes investment in property, plant & equipment, and in internally created intangible assets such as software.

Our capital investment programme in our gas transmission and distribution networks is based on an assessment of what is needed to maintain or improve the performance of our regulated networks, or to extend those networks where required to serve new sources of energy or new customers, usually in agreement with Ofgem, who permits us to earn a return on allowed investments. Capital investment in our Gas Metering business is to meet customer requirements.

During 2007/08, our capital investment was £1,393 million, compared with £1,200 million in 2006/07.

Talent

We aim to maximise the contribution of our employees by motivating them to strive for continued improvement, developing their skills and talents, and promoting a culture that recognises and respects inclusion and diversity. In addition to obtaining the views of employees on an ongoing basis, National Grid now carries out annual group-wide employee surveys to identify areas where we can improve.

Talent and skills	Identifying, recruiting and developing talented people are critical to our future success. We aim to support all our employees so that they can operate to the best of their abilities by creating an environment that allows them to realise their full potential.

We have strengthened our talent management processes in 2007/08, commencing with the creation of talent management plans for senior management and for business critical roles. In addition, for the first time, we conducted cross-business talent planning sessions using consistent processes to support senior management in developing employees within each business area and to address succession issues.

Our focus on developing the talent of our current and future business leaders has intensified, with continued growth in the number of participants in National Grid's leadership and management development programmes. The main areas of focus have been on our performance for growth programme, change management, leadership development and developing future leaders programmes, including the expansion of our change agent networks.

We continue to invest in the recruitment and development of skilled employees for the future, jointly with National Grid's other UK businesses, which have collectively recruited 157 trainees on to National Grid's apprentice, foundation engineer, graduate and student programmes in the past year.

Engagement and performance	To succeed, we need to engage our employees to strive for continued improvement. For that purpose our aim is to implement a world-class performance management process.

Our approach involves adopting integrated common performance processes and a single set of performance criteria, with pay linked to leadership qualities (how we deliver) as well as operational and financial performance (what we deliver), providing for clearer differentiation between levels of performance.

Employee engagement

As part of the implementation of National Grid's new operating model, a survey was carried out to gather feedback on the communication routes that employees prefer and a suite of communication channels is now being rolled out across the whole of National Grid.

In February 2008, National Grid conducted a comprehensive employee engagement survey, in which over 83% of its global work force took part in what will now be an annual exercise. Separate results are not available for the employees of National Grid Gas alone, but the survey demonstrated that our employees see our safety focused and supportive work environment as real strengths. Where they think that we can make progress is in the areas of providing more open and honest communications, greater clarity about our vision and direction, and a stronger link between performance and reward. Action plans are being developed and built into managers' objectives for the coming year.

Performance management

During the year, we successfully launched our Performance for Growth programme for our Directors and senior managers.

We continue to expand and embed our performance management process with an integrated common performance approach, including a single set of performance criteria, pay linked to leadership qualities, as well as operational and financial performance, and a clearer differentiation between levels of performance. During 2007/08, significant effort was put into the calibration of performance across the levels and businesses, with the objective of creating a fairer, more transparent and consistent process for evaluating and rewarding the performance of our employees.

Inclusion and diversity	In order to develop, recruit and retain talented people we aim to achieve a more inclusive and diverse workforce, reflecting the composition of the communities in which we operate, and to be seen as an employer of choice across diverse communities.
	Performance measures we use to monitor our objective of promoting inclusion and diversity include the percentage of female employees and the percentage of black and minority ethnic employees.

We are fortunate to have vibrant employee networks, focusing on gender, ethnicity and faith, disability, sexual orientation and new starters. These are helping us to better understand the different communities represented within our workforce, and to provide support and information to our employees. Action councils help to coordinate initiatives in each of our locations, to identify new initiatives and to ensure consistency across our businesses.

At 31 March 2008, 24.5% of employees were female and 5.8% were from black and minority ethnic groups compared with 20.0% and 4.5% respectively at 31 March 2007.

Relationships

We aim to enhance our relationships with all of our external stakeholders – investors, customers, regulators, government, suppliers and the communities in which we operate.

Investor relations	We aim to make National Grid Gas attractive to debt investors so that we can finance our operations as effectively as possible.

During the year, we participated in the presentations and conference calls targeted at debt investors and conducted by National Grid. Despite turbulent market conditions we have continued to issue long-term bonds, raising £700 million during the year.

Customers, regulators and government	The primary concern of our customers, regulators and the UK Government is that we deliver a safe, reliable and efficient service, now and into the future. Hence the foundation of our relationships reflects the quality of our operational performance.

For customers, it is important that we treat them with respect, that we communicate clearly and that we make interaction with them as straightforward as possible. Our focus on customer service and operational excellence is also a critical component of our relationship with Ofgem and the UK Government, underpinning the building of trust with them both. This involves being responsive to the need of Ofgem for high quality information, complying with rules and regulations, operating in an ethical way and, most importantly, delivering on our promises.

We continue to work very closely with Ofgem on the renewal of our gas transmission and distribution networks, and in expanding those networks to meet new and changing demand. In addition, we seek to maintain a professional approach with Ofgem in areas where we disagree, in particular with respect to their investigation into metering services as discussed on page 6.

Suppliers	We aim to work effectively in partnership with our suppliers, developing constructive relationships and working together effectively. Our objective is to develop contractual arrangements with our suppliers that align their interests with our own, as far as possible, and share financial risks appropriately.

Our objective is to use the scale and breadth of National Grid's activities to get the best value for money from our suppliers. National Grid has established a single procurement function covering all of its supply chain activities in the UK and the US as a key step on the way to delivering this objective.

During the year we implemented a new back office system, which has improved our ability to manage procurement activities as well as providing other benefits. Unfortunately, relationships with certain suppliers were temporarily hampered by teething problems with the new system, leading to delays in payment in some circumstances. We have resolved many of the issues that have arisen and we continue to address those that remain, aiming to ensure suppliers are paid on time while maintaining appropriate financial controls.

We also aim to build on our achievements in creating alliances with contractors to deliver construction projects in our Gas Distribution business, benefiting from the closer and more constructive working relationship that we believe can be achieved, when project objectives are aligned and financial risks are shared.

In addition to focusing on efficiency and value for money, we have established clear principles and objectives concerning the impact of our supply chain economically, socially, environmentally and on human rights. We expect our suppliers to address these wider areas in working with us.

Community involvement	Our role as a good corporate citizen supports National Grid's vision, and is delivered through a sustained and consistent approach.

Our community investment objectives include supporting communities, developing our business, supporting our employees and enhancing our reputation through targeted community involvement activities. Our approach continues to be centred on three key themes: energy and environment; education and skills; and community development.

During the year we have again reviewed our social policy to ensure our approach to community investment remains relevant to, and supports, society's wider social and environmental priorities. This review has included analysis of existing activities and best practice, across National Grid and externally.

We invested some £3.0 million in support of community initiatives and relationships across our operations in 2007/08.

Environment

We are committed to safeguarding the global environment for future generations, taking positive action to reduce our contribution to climate change and our other impacts on the environment.

Climate change	Climate change is possibly one of the greatest challenges facing society in the 21st century. National Grid's overall objective is to reduce its emissions of greenhouse gases by 80% against a verified baseline.
	Our key performance indicator to monitor our performance in this area is the annual percentage reduction in our greenhouse gas emissions. We also measure absolute emissions.

We report our greenhouse gas emissions in line with National Grid's corporate reporting principles which include National Grid's interpretation of the World Resources Institute Greenhouse Gas Protocol Initiative. This protocol provides a breakdown of our direct emissions (Scope 1), indirect emissions resulting from purchased electricity (Scope 2) and other indirect emissions (Scope 3). We believe this provides greater transparency and focuses attention on those emissions over which we have the greatest control.

During 2007/08, National Grid reviewed its climate change strategy (first approved in 2006), and concluded that it should increase its target of reducing Scope 1 and Scope 2 emissions of greenhouse gases to 80% against its verified baseline ahead of 2050, compared with its prior 60% reduction target. This target is ambitious and will challenge us to develop, now and over the next 42 years, new ways of conducting our business to reduce greenhouse gas emissions.

This revised 80% reduction target will be delivered through National Grid's climate change initiative, with a corporate team that will work with each line of business to deliver the target. The initiative is structured around three elements which we believe will transform our business:

- fully integrating sustainability and climate change considerations into our business decisions, including the setting of carbon budgets;
- influencing legislators and regulators to reshape energy markets to meet the climate change challenge; and
- helping and supporting our customers, employees and suppliers in changing their behaviours to be more considerate of the environment.

As National Grid Gas does not have a separate verified base line for greenhouse gas emissions, we monitor our emissions in terms of year on year reductions. During 2007/08, our Scope 1 and Scope 2 greenhouse gas emissions amounted to some 3.3 million tonnes CO_2 equivalent, a 3% reduction compared with emissions of 3.4 million tonnes in 2006/07.

Total Scope 1 and 2 emissions per £million of revenue amounted to some 1,337 tonnes CO_2 equivalent compared with 1,524 tonnes in 2006/07.

Methane leakage from our gas networks accounts for some 73% of this year's reported Scope 1 emissions. During the year, we replaced approximately 1,850 km of old cast iron pipes in the UK, the largest source of these emissions.

Historically contaminated land	National Grid Gas has an inherited portfolio of historically contaminated land including former manufactured gas plants and former gas holder stations. Sites can have a complex mix of contamination dating back over 100 years.

The main focus of our remediation programme is on managing the environmental risk by targeting those sites with the highest environmental risk profile and those where we have a legal or regulatory requirement to remediate, while returning land to productive public or private use where we can, and where it is surplus to operational requirements.

National Grid Property, a fellow subsidiary of National Grid, manages land contamination issues on our behalf.

Protecting the environment	Our objective is to help protect the environment for future generations and so we are committed to continuous improvement in our environmental performance by: ● efficient use of natural resources; ● keeping our waste to a minimum and increasing the economic value of any waste we produce; ● acting to prevent environmental incidents; and ● improving, where we can, the environmental status of the land on which we operate.
	Key performance indicators that we monitor in this area comprise the number of significant direct environmental incidents and the total value of fines from prosecutions.

All of our employees work to environmental management systems certified to the international standard ISO 14001.

The number of significant environmental incidents in 2007/08 arising directly from our operations was 26, which includes 24 contractor-related incidents. In 2006/07, there were 16 incidents including 13 contractor-related incidents. There were no prosecutions by enforcing bodies resulting from these incidents.

Financial performance

We aim to continue to improve our financial performance, to deliver returns appropriate to our risk profile and to be financially disciplined.

Profit and cash flow	If we achieve our objectives we should be able to deliver continued improvements in financial performance, contributing to National Grid's commitment to grow its dividend each year.
	The principal measures we use to monitor our financial performance are adjusted operating profit and operating cash flows. Adjusted operating profit is operating profit before exceptional items and remeasurements.

We report our financial results and position in accordance with International Financial Reporting Standards (IFRS).

Continuing and discontinued operations

The financial results of our business segments and of our other activities (as described on page 1) are presented within continuing operations. Discontinued operations comprise residual amounts in respect of the four gas distribution networks sold on 1 June 2005.

Measurement of financial performance and use of adjusted profit measures

In considering the financial performance of our businesses and segments, we analyse each of our primary financial measures of operating profit, profit before tax and profit for the year into two components, comprising firstly business performance, which excludes exceptional items and remeasurements and secondly exceptional items and remeasurements. Exceptional items and remeasurements are excluded from the measures of business performance used by management to monitor financial performance as they are considered to distort the comparability of our reported financial performance from year to year.

Measures of business performance are referred to in this Annual Report as adjusted profit measures in order to clearly distinguish them from the comparable total profit measures of which they are a component. Adjusted operating profit, adjusted profit before tax and adjusted earnings differ from total operating profit, profit before tax and profit for the year respectively by the exclusion of exceptional items and remeasurements.

Exceptional items and remeasurements are items of income and expenditure that, in the judgement of management, should be disclosed separately on the basis that they are material, either by virtue of their nature or size, and are relevant to an understanding of our financial performance. Items of income or expense that are considered by management for designation as exceptional items include such items as significant restructurings, write-downs or impairments of non-current assets, material changes in environmental provisions and gains or losses on disposals of businesses or investments. Remeasurements comprise gains or losses recorded in the income statement arising from changes in the fair value of derivative financial instruments. These fair values increase or decrease as a consequence of changes in financial indices and prices over which we have no control.

Adjusted profit measures are limited in their usefulness compared with the comparable total profit measures, as they exclude important elements of our underlying financial performance, namely exceptional items and remeasurements. We believe that in separately presenting financial performance in two components it is easier to read and interpret financial performance between periods, as adjusted profit measures are more comparable by excluding the distorting effect of exceptional items and remeasurements, and exceptional items and remeasurements are more clearly understood if separately identified and analysed. The presentation of these two components of financial performance is additional to, and not a substitute for, the comparable total profit measures presented.

Management uses adjusted profit measures as the basis for monitoring financial performance and in communicating financial performance to investors in external presentations and announcements of financial results. Internal financial reports, budgets and forecasts are primarily prepared on the basis of adjusted profit measures, although planned exceptional items, such as significant restructurings, are also reflected in budgets and forecasts. Management compensates for the limitations inherent in the use of adjusted profit measures through the separate monitoring and disclosure of exceptional items and remeasurements as a component of our overall financial performance.

Operating financial performance

Details of the financial results of business segments, including information on exceptional items and remeasurements, are included in the business reviews on pages 18 to 26.

	Years ended 31 March	
	2008	2007
Continuing operations	**£m**	£m
Revenue	**2,440**	2,199
Other operating income	**8**	-
Operating costs	**(1,477)**	(1,421)
Total operating profit	**971**	778
Analysed as:		
Adjusted operating profit	**994**	792
Exceptional items	**(23)**	(14)
Total operating profit	**971**	778

The following tables set out the consolidated revenue, adjusted operating profit and operating profit by business segment.

Revenue by business segment

	Years ended 31 March	
	2008	2007
Continuing operations	**£m**	£m
Gas Transmission	**770**	736
Gas Distribution	**1,383**	1,174
Gas Metering	**349**	346
Other activities	**38**	35
Total segmental revenues	**2,540**	2,291
Less: sales between business segments	**(100)**	(92)
Revenue	**2,440**	2,199

Segmental operating profit before exceptional items and remeasurements

	Years ended 31 March	
	2008	2007
Continuing operations	**£m**	£m
Gas Transmission	**318**	312
Gas Distribution	**595**	406
Gas Metering	**101**	107
Other activities	**(20)**	(33)
Adjusted operating profit	**994**	792

Segmental total operating profit

Continuing operations	Years ended 31 March 2008 £m	2007 £m
Gas Transmission	**315**	307
Gas Distribution	**575**	397
Gas Metering	**101**	107
Other activities	**(20)**	(33)
Total operating profit	**971**	778

2007/08 compared with 2006/07

Changes in revenue and other operating income, operating costs and operating profit for 2007/08 compared with 2006/07 can be summarised as follows:

Continuing operations	Revenue and other operating income £m	Operating costs £m	Operating profit £m
2006/07 results	2,199	(1,421)	778
Add back 2006/07 exceptional items	-	14	14
2006/07 adjusted results	2,199	(1,407)	792
Gas Transmission	34	(28)	6
Gas Distribution	217	(28)	189
Gas Metering	3	(9)	(6)
Other activities	3	10	13
Sales between businesses	(8)	8	-
2007/08 adjusted results	2,448	(1,454)	994
2007/08 exceptional items	-	(23)	(23)
2007/08 results	2,448	(1,477)	971

Revenue and other operating income was £249 million higher than in 2006/07, primarily as a result of higher Gas Transmission and Gas Distribution revenues. Operating costs excluding exceptional items increased by £47 million as a result of higher operating costs in Gas Transmission and Gas Distribution, partly offset by a reduction in the costs of other activities. As a consequence, adjusted operating profit was £202 million higher than 2006/07.

Net operating exceptional charges of £23 million in 2007/08 were £9 million higher than 2006/07. They relate to restructuring costs including the establishment of the UK shared services function and business process reviews within Gas Transmission and Gas Distribution.

As a result of the £202 million increase in adjusted operating profit, partly offset by the £9 million increase in operating exceptional charges, total operating profit rose by £193 million between 2006/07 and 2007/08.

Profit for the year from continuing operations

Adjusted earnings

Continuing operations	Years ended 31 March 2008 £m	2007 £m
Adjusted operating profit	**994**	792
Net finance costs excluding exceptional items and remeasurements	**(341)**	(243)
Adjusted profit before taxation	**653**	549
Taxation excluding taxation on exceptional items and remeasurements	**(278)**	(239)
Adjusted profit from continuing operations	**375**	310

Earnings

Continuing operations	Years ended 31 March 2008 £m	2007 £m
Total operating profit	**971**	778
Net finance costs	**(317)**	(271)
Profit before taxation	**654**	507
Taxation	**(161)**	(232)
Profit from continuing operations	**493**	275

Net finance costs

Net interest excluding exceptional finance costs and remeasurements increased by £98 million from 2006/07 to 2007/08. This was primarily explained by an increase in average debt balances.

Exceptional finance costs and remeasurements

There were no exceptional finance costs in 2007/08. Exceptional finance costs of £32 million in 2006/07 relate to the early repayment of debt.

Financial remeasurements relate to net gains on derivative financial instruments of £24 million, compared with net gains of £4 million in 2006/07.

Taxation

A net charge of £161 million arose in 2007/08 comprising a £278 million charge on adjusted profit before tax and a £117 million credit on exceptional items and remeasurements. This compares with a net charge of £232 million in 2006/07, comprising a £239 million charge on adjusted profit before tax and a £7 million credit on exceptional items and remeasurements. The 2007/08 net charge included an exceptional credit of £117 million in 2007/08 relating to the release of deferred tax provisions following the change in the UK corporation tax rate from 30% to 28% which was enacted in the year and takes effect from 1 April 2008.

The effective tax rate before and after exceptional items and remeasurements was 43% and 25% respectively (2006/07: 44% and 46%), compared with a standard UK corporation tax rate of 30% for both years.

The effective tax rates before exceptional items reflect prior year tax charges equivalent to an effective tax rate of 17% in 2007/08 and 12% in 2006/07. These prior year items principally relate to additional tax arising under UK transfer pricing arrangements, which is offset by equivalent tax credits in other UK companies in the National Grid group.

Profit for the year from continuing operations
Profit for the year from continuing operations rose from £275 million in 2006/07 to £493 million in 2007/08 as a consequence of the above changes.

Adjusted profit measures

The following tables reconcile the adjusted profit measure to the corresponding total profit measure in accordance with IFRS.

Reconciliation of adjusted operating profit to total operating profit

	Years ended 31 March	
	2008	2007
Continuing operations	**£m**	£m
Adjusted operating profit	**994**	792
Exceptional items	**(23)**	(14)
Total operating profit	**971**	778

Adjusted operating profit is presented on the face of the consolidated income statement, under the heading 'Operating profit – before exceptional items'.

Reconciliation of adjusted profit before taxation to profit before taxation

	Years ended 31 March	
	2008	2007
Continuing operations	**£m**	£m
Adjusted profit before taxation	**653**	549
Exceptional items	**(23)**	(46)
Derivative financial remeasurements	**24**	4
Total profit before taxation	**654**	507

Adjusted profit before taxation is presented on the face of the consolidated income statement, under the heading 'Profit before taxation – before exceptional items and remeasurements'.

Reconciliation of adjusted earnings to earnings (profit for the year from continuing operations)

	Years ended 31 March	
	2008	2007
Continuing operations	**£m**	£m
Adjusted earnings	**375**	310
Exceptional items	**101**	(32)
Derivative financial remeasurements	**17**	(3)
Earnings	**493**	275

Adjusted earnings is presented on the face of the consolidated income statement, under the heading 'Profit for the year from continuing operations after taxation – before exceptional items and remeasurements'.

Discontinued operations

	Years ended 31 March	
	2008	2007
	£m	£m
Gain on disposal of discontinued operations	**3**	13
Profit for the year	**3**	13

Discontinued operations comprise amounts in respect of the four regional gas distribution networks we sold on 1 June 2005.

Net profit for the year

Net profit from both continuing and discontinued operations was £496 million in 2007/08 compared with £288 million in 2006/07.

Cash flows

Cash flows from operating activities
Cash generated from continuing operations was £1,555 million in 2007/08 compared with £1,407 million in 2006/07. This included cash outflows relating to exceptional items of £23 million and £27 million respectively. After reflecting cash flows relating to taxation, the net cash inflow from operating activities was £1,327 million, compared with £1,417 million in 2006/07.

In 2007/08, there was a net corporate tax payment of £228 million compared with a repayment of £10 million in 2006/07.

Cash flows from investing activities
Cash outflows from continuing operations investing activities rose from £1,501 million in 2006/07 to £1,606 million in 2007/08. Cash outflows to purchase property, plant and equipment and intangible fixed assets, net of disposal proceeds, increased to £1,470 million in 2007/08 from £1,163 million in 2006/07, as a result of the increase in capital investment. Cash outflows to acquire financial investments decreased from £338 million in 2006/07 to £136 million in 2007/08.

Cash flows in respect of sales proceeds of discontinued operations comprised a net outflow of £1 million in 2007/08 compared with a net inflow of £28 million in 2006/07.

Cash flows from financing activities
The net cash inflow from financing activities increased from £1 million in 2006/07 to £111 million in 2007/08. This reflected net inflows from loans of £852 million (2006/07: £2,178 million inflow) and net payments to providers of finance, in the form of net interest and dividends, of £741 million (2006/07: £2,177 million).

Net interest cash outflows, excluding exceptional debt redemption costs, decreased from £295 million in 2006/07 to £241 million in 2007/08. There were no exceptional debt redemption payments in 2007/08 compared with £32 million in 2006/07 which arose from restructuring our debt portfolio.

Returns on our investments	We aim to generate value from our investments by improving the operating performance of our networks and by selecting investments that will provide the best return.
	Measures we use to monitor the value we generate from our investments include the returns generated by our regulated businesses.

We measure the financial performance of our regulated gas transmission and distribution business using an operational return metric comparable to the vanilla return defined in our price controls. In 2007/08, Gas Transmission achieved an operational return of 7.2% compared with 7.3% in 2006/07, and Gas Distribution achieved a return of 5.1% compared with 5.0% in 2006/07.

Further details of these operational returns are provided in the business review sections on pages 20 and 23.

Financial discipline	In order to deliver sustainable growth we must be disciplined in the way we manage our balance sheet. This means that our parent National Grid will return cash to its shareholders to the extent it is not required for investment objectives.
	The principal measure we use to monitor financial discipline is adjusted gearing ratio. This is the ratio of net debt to net assets plus net debt, with the assets of our regulated gas transmission and distribution businesses measured at their estimated regulatory values.

Our adjusted gearing ratio amounted to 44% at 31 March 2008 compared with 40% 31 March 2007.

A reconciliation of the amounts necessary to calculate the adjusted gearing ratio is shown in the table below:

	2008 £m	2007 £m
Net assets per balance sheet	**5,980**	5,967
Adjustments for regulatory asset values	**2,645**	2,380
Deferred tax on adjustments	**(741)**	(714)
Adjusted net assets	**7,884**	7,633
Net debt	**6,174**	5,184
Adjusted net assets plus net debt	**14,058**	12,817

Dividends in respect of the financial year

	2008 £m	2007 £m
Interim	**500**	350

The table above shows the ordinary dividends paid or payable by National Grid Gas in respect of the last two financial years. These dividends do not include any associated UK tax credit in respect of such dividends.

Gas Transmission

About Gas Transmission

This section should be read in conjunction with the rest of this Operating and Financial Review, in particular vision, strategy and objectives, business drivers and risks, and external and regulatory environments as set out on pages 2 to 5.

Principal operations

Our Gas Transmission business comprises the following principal activities:

Gas transmission owner	We own the gas national transmission system in Great Britain. This comprises approximately 7,400 kilometres of high pressure pipe and 26 compressor stations, connecting to 8 distribution networks and to third party independent systems for onward transportation of gas to end consumers.
Gas system operator	We operate the gas national transmission system. Day-to-day operation includes balancing supply and demand, maintaining satisfactory system pressures and ensuring gas quality standards are met.
LNG storage	We own and operate four LNG storage facilities in Great Britain.

As gas transmission owner, we own and maintain the physical assets, develop the network to accommodate new connections and disconnections, and manage a programme of asset replacement and investment to ensure the long-term reliability of the network.

As gas system operator, we undertake a range of activities necessary for the successful, efficient delivery, in real-time, of secure and reliable energy. We ensure the system is balanced with supply and demand at the end of each day. We are also required to maintain levels of short-term gas reserves to ensure that domestic and other non-interruptible gas supplies can be maintained during prolonged cold conditions.

Regulation

The Company holds a gas transporter licence in respect of the national transmission system. Under the Gas Act 1986 we have a duty to develop and maintain an efficient and economical pipeline system for the conveyance of gas. Our LNG storage business is managed as a separate business from the gas transmission business. However, it is regulated under our gas transporter licence.

Ofgem sets price controls in respect of the amounts that can be charged by the owners and operators of gas infrastructure in the UK. These controls are reviewed every five years and the current price control for gas transmission activities covers the period 1 April 2007 to 31 March 2012.

The key elements of the current price control are that we earn a 4.4% post-tax real rate of return on our regulatory asset value, a £0.9 billion baseline five year capital expenditure allowance and a £0.3 billion five year operating expenditure allowance.

The charges that we can make for access to our gas transmission system are determined by a formula linked to the Retail Prices Index (RPI). This formula is based upon Ofgem's estimates of our operating expenditure, capital expenditure and asset replacement, together with an allowed rate of return.

In addition, our gas system operation activities are subject to financial incentive schemes to promote efficiency. If we operate our network more efficiently than Ofgem's forecasts, we can increase our revenues, with penalties for reductions in performance.

We have a number of incentive schemes covering activities such as cost of investment for additional capacity to facilitate new connections to the system, managing constraints, the provision of market information, the cost of purchasing shrinkage gas (gas used in operating the system) and other gas system operation costs.

Current and future developments

In addition to the current and future developments described on page 6, the following developments are relevant to the Gas Transmission business.

Price controls

The previous price control arrangements for our gas transmission networks in the UK ceased on 31 March 2007 and the current price control period covers the period from 1 April 2007 to 31 March 2012. Following our acceptance in principle of the proposals, we have worked closely with Ofgem to agree the necessary licence amendments to enact the final proposals.

We also accepted Ofgem's final proposals for the system operator schemes that applied to 2007/08 and their proposals for the one year period from 1 April 2008.

Other developments

The 316 kilometre pipeline connecting the new LNG importation terminals at Milford Haven has been completed on time and in advance of the terminals. The pipeline is the largest single extension to the system since it was originally constructed and has been delivered to a very challenging timetable. It was formally opened by UK Energy Minister, Malcolm Wickes, in November 2007.

The pipeline will initially have to operate at 70 bar pressure rather than its design pressure of 94 bar because, following a public inquiry, planning permission has been refused for a pressure reduction installation at the end of the pipeline at Tirley in Gloucestershire. The effect of this is to reduce the pipelines capacity by approximately 25% and a force majeure notice for this shortfall has been issued under our contracts with the gas shippers. Work is progressing towards the submission of revised planning applications in autumn 2008.

Major pipelines have also been completed and commissioned from Nether Kellett in Lancashire, to Pannal in North Yorkshire, as part of works to import gas from Norwegian gas fields through Easington and in south west England to meet increased demand requirements.

Performance against our objectives

Descriptions of our progress against our overall objectives in the areas of delivering National Grid's strategy, operating performance, talent, relationships, environment, financial performance and responsibility are set out on pages 10 to 18. We include below further information specific to Gas Transmission with respect to the progress we have made on transformation, our operating performance and our financial performance.

Delivering National Grid's strategy

Key areas of focus	Key areas of focus for our Gas Transmission business for 2007/08 have been to improve safety performance and to improve processes for network operations, within-year planning, transmission construction and asset management.

Achievements so far have been the sharing of best practice with regard to safety, the development of a common financial approval process.

During 2007/08, we completed a business process review, focused on improving the efficiency of delivery of our capital investment programme and operation efficiencies to meet the challenges within our price control plans. This has been based on improving our operational planning, engaging with external parties on the practical issues surrounding access to our assets and the management of land and managing a higher volume of work that is potentially more volatile if not managed effectively. We have also been working with our suppliers to constrain or reduce costs wherever possible, with the aim of using the scale of our operations, and the increased level of capital expenditure, to increase efficiency.

Operating performance

Safety	Our aim is for zero lost time injuries.

During 2007/08 there were 5 lost time injuries compared with 5 in 2006/07. The lost time injury frequency rate was 0.36 in 2007/08 compared with 0.29 in 2006/07.

Efficiency	Our objective is to be more efficient in the delivery of services, in the context of higher expectations from our customers and cost pressures.

We have been undertaking a number of internal business process reviews to seek out further savings without compromising our other objectives. Efficiency is reflected in our financial performance, which is discussed below.

Reliability	Our aim is to meet or exceed network reliability and availability objectives.

The winter of 2007/08 saw a maximum gas demand of 419 million cubic metres on 17 and 20 December 2007. This is lower than the previous year's peak of 436 million cubic metres.

We again achieved our target of 100% reliability for the gas transmission network.

Gas compressor fleet performance declined during 2007/08, with the mean time between compressor failures falling to 259 hours compared with 430 hours in 2006/07. In order to improve gas compressor resilience and to support variations in operating conditions such as we experienced this year, we are progressing investments in electrical drive compressors at approximately 20% of our sites.

Customer service	Our aim is to support gas distribution network customers, including our own networks operated by Gas Distribution, in delivering energy efficiently and effectively to consumers, in particular in connecting new sources of supply to our transmission networks.

Our transmission customer service activities principally relate to facilitating new connections and maintaining existing connections and relationships with the customers who are already connected.

Capital investment	Our aim is to deliver our planned capital investment programme involving approximately £2 billion of capital expenditure between 1 April 2007 and 31 March 2012.

Investment in gas transmission systems is, by its nature, variable and is largely driven by changing sources of supply and asset replacement requirements. Our gas transporter licence also obliges us to provide connections and capacity upon request.

Parts of the gas transmission network are reaching the end of their lives. These are mainly compressor stations, control systems and valves (ie above ground assets and not the high pressure pipes). This, together with work required to meet changing supply sources, means that the Gas Transmission business has embarked on a significant increase in investment and network renewal.

Capital investment in the replacement, reinforcement and extension of the Gas Transmission systems in 2007/08 was £800 million compared with £628 million in 2006/07. 2007/08 has seen a further substantial increase in the level of investment in gas pipeline projects, some £138 million higher than 2006/07.

Financial performance

Profit	Our objective is to drive continuous profit growth.

Our adjusted operating profit, excluding exceptional items, for Gas Transmission of £318 million is £6 million higher than 2006/07.

Returns on investment	Our objective is to deliver strong financial returns compared to the regulatory allowances within our price controls.
	We measure the financial performance of our Gas Transmission business using an operational return metric, comparable to the vanilla return defined in the price controls from 1 April 2007. This metric expresses profit on a price control basis as a percentage of our estimated regulatory value.

In 2007/08, we achieved a 7.2% return, significantly outperforming regulatory assumptions, mainly as a result of performance under our incentive schemes. This compares with an operational return of 7.3% in 2006/07 calculated on the same basis.

Financial results

The results for the Gas Transmission segment for the years ended 31 March 2008 and 2007 were as follows:

	Years ended 31 March	
	2008	2007
	£m	£m
Revenue	**770**	736
Operating costs excluding exceptional items	**(452)**	(424)
Adjusted operating profit	**318**	312
Exceptional items	**(3)**	(5)
Operating profit	**315**	307

The principal movements between 2006/07 and 2007/08 can be summarised as follows:

	Revenue	Operating costs	Operating profit
	£m	£m	£m
2006/07 results	736	(429)	307
Add back 2006/07 exceptional items	-	5	5
2006/07 adjusted results	736	(424)	312
Allowed revenues	91	-	91
Timing of recoveries	(3)	-	(3)
LNG storage auction revenue	(41)	-	(41)
Depreciation and amortisation	-	(23)	(23)
Other	(13)	(5)	(18)
2007/08 adjusted results	770	(452)	318
2007/08 exceptional items	-	(3)	(3)
2007/08 results	770	(455)	315

Revenue increased by £34 million in 2007/08 compared with 2006/07. Allowed revenues increased by £91 million, driven by the five-year transmission price controls that came into effect on 1 April 2007. As expected, revenues from our LNG storage business were lower in 2007/08, down by £41 million on 2006/07, as demand for capacity returned closer to normal levels following the abnormal demand in 2006/07.

Operating costs, excluding exceptional items, increased by £28 million in 2007/08 compared to 2006/07. As expected, depreciation and amortisation increased by £23 million as a result of increasing capital investment. Other cost increases of £5 million are due to higher pass-through costs which are recovered through revenue. Exceptional charges of £3 million in 2007/08 and £5 million in 2006/07 relate to costs incurred in establishing a shared services function in the UK and from the transmission business process review.

As a consequence of these items, adjusted operating profit, excluding exceptional items, increased by £6 million in 2007/08 compared with 2006/07, while operating profit increased by £8 million.

Gas Distribution

About Gas Distribution

This section should be read in conjunction with the rest of this Operating and Financial Review, in particular vision, strategy and objectives, business drivers and risks, and external and regulatory environments as set out on pages 2 to 5.

Principal operations

Our Gas Distribution business comprises four of the eight regional gas distribution networks in Great Britain. Our networks consist of approximately 132,000 kilometres of gas distribution pipelines and we transport gas on behalf of approximately 33 active gas shippers, from the gas national transmission system to around 10.8 million consumers.

We also manage the national emergency number (0800 111 999) for all of the gas distribution networks and for other gas transporters in the UK. During 2007/08 we handled approximately 3.5 million calls to the national emergency number.

Regulation

We hold a single gas distribution transporter licence, which authorises us to operate the four gas distribution networks we own. Detailed arrangements for transporting gas are provided through the Uniform Network Code which defines the obligations, responsibilities and roles of industry participants and is approved by Ofgem.

Our four regional gas distribution networks each have a separate price control, which determines the maximum prices we can charge to gas shippers for our gas delivery service. These maximum prices are based on Ofgem's allowances for operating, capital and replacement expenditure, together with depreciation of and a return on Ofgem's allowances for our regulatory asset value.

The price controls that applied to our gas distribution networks during the year ended 31 March 2008 were an extension of our previous price controls, which were based on a real pre-tax rate of 6.25% on our regulatory asset value.

The next full price control period came into force on 1 April 2008 and covers the period up to 31 March 2013. This review allows for capital expenditure of £0.7 billion and mains replacement expenditure of £2.2 billion over that period. These allowances are expected to grow our asset base by almost 25% over the 5 years.

As at 31 March 2008, our regulatory asset value is estimated at approximately £6.5 billion.

The price control formulae specify a maximum allowed revenue assigned to each network. Each formula consists of a fixed core revenue, cost pass-through items, a mains replacement adjustment mechanism and shrinkage and exit capacity incentive terms. Transportation charges are set broadly to recover allowed revenue, but in any year, collected revenue can be more or less than allowed. Any difference is carried forward and our charges are adjusted accordingly in future periods.

Replacement expenditure maintains the safety and reliability of the network, by replacing older gas pipes with modern pipes. Ofgem treats 50% of projected replacement expenditure as recoverable during the price control period and 50% as recoverable over future years. Each network is subject to its own mains replacement incentive mechanism and retains 33% of any outperformance against Ofgem's annual cost targets as additional return or, alternatively, bears 50% of any overspend if it underperforms.

Ofgem has established standards of service we are required to meet. These include:

- overall standards of service, for example answering 90% of all calls to the national gas emergency number within 30 seconds of the call being connected and attending 97% of reports of a gas escape or other gas emergency within the required timescale;
- connections standards of service that require us to provide connections to customers to agreed timescales after an unplanned interruption; and
- guaranteed standards of service for our other transportation services.

Compensation is paid to consumers for any failures to meet guaranteed standards of service and the connections standards of service.

Current and future developments

Ofgem extended the previous five year gas distribution price controls for a further year to cover the year ending 31 March 2008. The principal impact of these one year price control extensions is to increase prices by approximately 11% and to reduce the seasonality of revenues. In addition, the balance between fixed and variable elements in our revenue changed, reducing the impact that volume changes, including weather, had on our revenue in 2007/08 compared with previous years.

On 18 December 2007 we accepted Ofgem's final proposals for new distribution price controls, covering the period from 1 April 2008 to 31 March 2013. The key elements of these proposals are a 4.3% post-tax real rate of return on our regulatory asset value, a £2.9 billion baseline five year capital expenditure allowance and a £1.9 billion five year operating expenditure allowance.

Performance against our objectives

Descriptions of our progress against our overall objectives in the areas of delivering National Grid's strategy, operating performance, talent, relationships, environment, financial performance and responsibility are set out on pages 10 to 18. We include below further information specific to Gas Distribution with respect to the progress we have made on transformation, our operating performance and our financial performance.

Delivering National Grid's strategy

Key areas of focus	Our objective is to utilise the scale and breadth of National Grid's combined UK and US gas distribution operations, together with the benefits of common support services, to drive improvements in our operating and financial performance. In particular, we aim to share and adopt best practices across gas distribution.

We have integrated the management of our four gas distribution networks in England with National Grid's US gas networks, as part of National Grid's plan to create a single gas distribution business operating in both the UK and the US. A new management team for the enlarged business has been appointed, reporting to Mark Fairbairn, the Executive Director of National Grid with responsibility for gas distribution.

One of the key benefits of this integration is the sharing of best practices and standardising technologies should drive operating and financial improvements.

A number of new approaches have already been implemented with tangible benefits. For example, advanced excavation techniques employing a coring machine and vacuum unit has allowed holes, on average one-quarter the size of conventional excavations. This technique also improves the safety of the crew, limits traffic congestion, and reduces the volume of material disposed of in a landfill. This technique was adopted from our US operations and is now being utilised in the UK on gas leakage repairs.

Operating performance

Safety	Our objective is to reduce employee lost time injuries to zero.

Lost time injuries numbered 15 in 2007/08 compared with 21 in 2006/07. The lost time injury frequency rate was 0.17 compared with 0.16 in 2006/07.

We again exceeded our targets on safety-related standards set by Ofgem. More than 98% of 'uncontrolled' gas escapes (where the gas leak cannot be controlled by turning the gas supply off at the meter) were attended within one hour, and more than 99% of 'controlled' gas escapes (where the gas leak can be controlled at the meter) were attended within two hours. The target is 97% attendance in both cases.

We have decommissioned approximately 1,850 kilometres of gas pipes in 2007/08, exceeding the target of 1,835 kilometres agreed with the HSE target for the second consecutive year. We decommissioned 1,850 kilometres in 2006/07.

Efficiency	Our objective is to increase the efficiency of Gas Distribution operations.

We have undertaken a number of internal process reviews to advance the alignment of our operations with the aspiration of removing duplication and waste.

We have improved the efficiency of our mains replacement activities by tackling larger projects through taking a zonal approach. We have also used technology, such as vacuum excavation, transferred from the US, to allow jobs to be completed more efficiently.

Reliability	Our objective is to meet regulatory targets and to have zero loss of supply incidents.

Actual gas consumption was 315 TWh in 2007/08, compared with 303 TWh in 2006/07. This was equivalent to underlying levels of gas demand, excluding the effects of weather, of 329 TWh in 2007/08 compared with 331 TWh in 2006/07.

Over the year, we have achieved all our standards of service set by Ofgem that relate to our gas transportation services.

Customer service	In addition to meeting customer service objectives agreed with our regulators, our objective is to be within the upper quartile of customer satisfaction.

We have achieved all our connections standards of service over the year, along with all other standards of service set by Ofgem that relate to our gas transportation services.

During 2007/08, we made around 45,000 new connections to our network (2006/07: 40,000). The proportion of planned service interruptions (as against unplanned) in 2007/08 was 99.175% (2006/07: 98.92%) compared with a target of 95%, while the proportion of customer complaints responded to within five working days was 96.1% in 2007/08 (2006/07: 94.7%) compared with a target of 90%.

Capital investment	Our aim is to deliver over £2 billion of capital investment by 2012 in line with our price control allowance.

Gross investment including reinforcement, extension and replacement of the gas distribution network was £514 million in 2007/08 compared with £487 million in 2006/07. Of these amounts, £353 million in 2007/08 related to the gas mains replacement programme (2006/07: £333 million) and £161 to other capital investment including new connections, new pipelines and minor capital expenditure (2006/07: £154 million). Expenditure on software applications included within the above amounts amounted to £18 million (2006/07: £12 million).

Replacement expenditure has increased by 20% since 2005/06, reflecting the substantial increase in planned workload under the long-term mains replacement programme agreed with the Health and Safety Executive.

During the third year of our alliance partnerships for Gas Distribution, we have laid approximately 1,850 kilometres of iron gas mains with an increasing proportion of our workload comprising complex replacement of large diameter mains. Performance under the mains replacement incentive scheme has been held broadly neutral in 2007/08. The increase in other capital expenditure in 2007/08 compared with 2006/07 was because of a higher level of investment in the reinforcement of high pressure pipelines, such projects being dependent on forecasts of future demand, together with higher expenditure on new connections, the replacement of commercial vehicles and information technology, including the replacement of obsolete equipment in system control, operational and support activities.

Financial performance

Profits	Our objective is to increase profits each year.

Our adjusted operating profit was £595 million in 2007/08 compared with £406 million in 2006/07.

Returns on investment	Our aim is to meet or exceed the base investment financial returns in our price controls.
	We measure the financial performance of our Gas Distribution business using an operational return metric, comparable to the vanilla return defined in the price controls from 1 April 2007. This metric expresses profit on a price control basis as a percentage of our estimated regulatory value.

Gas Distribution achieved a 5.1% operational return in 2007/08, broadly in line with the regulatory allowance. This compares with an operational return of 5.0% in 2006/07 calculated on the same basis.

Financial results

The results for the Gas Distribution segment for the years ended 31 March 2008 and 2007 were as follows:

	Years ended 31 March	
	2008	2007
Continuing operations	**£m**	£m
Revenue	**1,383**	1,174
Other operating income	**8**	-
Operating costs excluding exceptional items	**(796)**	(768)
Adjusted operating profit	**595**	406
Exceptional items	**(20)**	(9)
Total operating profit	**575**	397

The principal movements between 2006/07 and 2007/08 can be summarised as follows:

Continuing operations	Revenue and other operating income £m	Operating costs £m	Operating profit £m
2006/07 results	1,174	(777)	397
Add back 2006/07 exceptional items	-	9	9
2006/07 adjusted results	1,174	(768)	406
Allowed revenues	146	-	146
Timing of recoveries	59	-	59
Depreciation and amortisation	-	(11)	(11)
Pass-through costs	-	(18)	(18)
Other revenues and costs	12	1	13
2007/08 adjusted results	1,391	(796)	595
2007/08 exceptional items	-	(20)	(20)
2007/08 results	1,391	(816)	575

Revenue and other operating income in Gas Distribution increased by £217 million in 2007/08 compared with 2006/07. This was mainly due to increases in allowed revenues, with the one year price control extension increasing allowed revenue by £165m, and the timing of recoveries of allowed revenues.

Allowed revenue is no longer linked to delivery volumes: this decoupling now eliminates the sensitivity to warm weather and lower underlying volumes. Furthermore, a smaller proportion of our income is recovered through the volume delivery component of our charges.

Cooler temperatures than the prior year increased consumption by 14 TWh, which was partially offset by the impact of underlying volumes being lower by 2 TWh.

The net year-on-year timing impact against allowed revenues was £59 million in 2007/08. There was a net benefit of £26 million (comprising the recovery of £43 million relating to the previous year, partially offset by a £17 million under-recovery for 2007/08), compared with a net detriment of £33 million in 2006/07 (comprising a £43 million under-recovery for 2006/07, partially offset by £10 million recovered relating to 2005/06).

Operating costs, excluding exceptional items, were £28 million higher in 2007/08 compared with 2006/07. Depreciation and amortisation costs were £11 million higher reflecting the increased capital investment in the distribution network. In line with 2006/07, there was a further £12 million increase in business rates, following the changes in rateable values introduced from 1 April 2005. From 2007/08 there is an extra allowance of £12 million for the recovery of non-active members' pension costs.

Exceptional charges of £20 million in 2007/08 related primarily to the creation of the new shared services organisation in the UK and global information services function, together with pension costs associated with these restructuring programmes. This compared with a £9 million cost in 2006/07.

As a consequence of the above, adjusted operating profit excluding exceptional items was £189 million higher in 2007/08 than 2006/07, an increase of 47%. Including exceptional items, operating profit was £178 million higher in 2007/08 than 2006/07, an increase of 45%.

Gas Metering

About Gas Metering

This section should be read in conjunction with the rest of this Operating and Financial Review, in particular vision, strategy and objectives, business drivers and risks, and external and regulatory environments as set out on pages 2 to 5.

Principal operations

Our Gas Metering business, which is undertaken through our subsidiary National Grid Metering Limited, provides installation, maintenance and meter reading services to gas suppliers in the regulated gas market. It provides services for domestic, industrial and commercial gas meters, situated throughout Great Britain.

External market and regulatory environment

Gas Metering is regulated by Ofgem as it was the incumbent provider of meters to gas suppliers and retains a large share of the legacy installed base of gas meters in Great Britain. It is subject to price controls, although the pricing for the majority of meters is instead specified by long-term contracts which provide gas suppliers with the flexibility to replace our meters while reducing the risk of asset stranding.

Gas Metering's share of the UK gas metering market is steadily shrinking as its meters are displaced by meters provided by unregulated suppliers.

Current and future developments

On 25 February 2008 Ofgem announced a decision that we had infringed the Competition Act in relation to development of term contracts entered into with gas suppliers in 2004. A fine of £41.6 million was imposed, but has been suspended pending appeal.

We are convinced that the contracts do not infringe competition law and therefore believe that they should remain in full effect. We also believe that the £41.6m fine is wholly inappropriate. An appeal has been lodged with the Competition Appeal Tribunal.

Performance against our objectives

Descriptions of our progress against our overall objectives in the areas of delivering National Grid's strategy, operating performance, talent, relationships, environment, financial performance and responsibility are set out on pages 10 to 18. We include below further information specific to Gas Metering with respect to the progress we have made on transformation, our operating performance and our financial performance.

Delivering National Grid's strategy

Key areas of focus	Our objective is to maximise profits and increase customer satisfaction by improving operational efficiency and investing in new technology.

We have continued to focus on improving the standard of service we offer to our customers and are trialling a number of new technologies which we believe will better meet customer needs and reduce costs.

Following the end of the financial year we have changed management responsibilities for Gas Metering, which will now report to Mark Fairbairn, National Grid's Executive Director for Gas Distribution.

Operating performance

Safety	Our objective is zero employee and contractor lost time injuries.

There were no employee lost time injuries in 2007/08 compared with 3 in 2006/07.

Efficiency	Our objective is to increase the efficiency of Gas Metering operations to maximise financial performance.

Efficiency is reflected in our financial performance, which is discussed below.

Reliability and customer service	Our objective is to improve the quality and reliability of our service to our customers.

All 22 standards of service have been met for the year ended 31 March 2008.

Capital investment	Our objective is to deliver on our capital investment programme.

In addition to providing meters for new gas connections and replacing older meters, National Grid Metering is investing in technology such as automated meter reading systems in response to customer requirements.

Capital expenditure in 2007/08 amounted to £73 million, a decrease of £9 million compared with £82 million in 2006/07. This decrease was mainly attributable to a lower level of meter exchanges.

Financial performance

Profit	Our aim is to maximise profits from existing assets and contracts.

The results for the Gas Metering segment for the years ended 31 March 2008 and 2007 were as follows:

	Years ended 31 March	
	2008	2007
	£m	£m
Revenue	**349**	346
Operating costs excluding exceptional items	**(248)**	(239)
Adjusted operating profit	**101**	107
Exceptional items	**-**	-
Total operating profit	**101**	107

2007/08 compared with 2006/07

The principal movements between 2006/07 and 2007/08 can be summarised as follows:

	Revenue	Operating costs	Operating profit
	£m	£m	£m
2006/07 results	346	(239)	107
Add back 2006/07 exceptional items	-	-	-
2006/07 adjusted results	346	(239)	107
One-off operational costs	-	(9)	(9)
Depreciation and amortisation	-	5	5
Other	3	(5)	(2)
2007/08 adjusted results	349	(248)	101
2007/08 exceptional items	-	-	-
2007/08 results	349	(248)	101

Revenue for Gas Metering increased by £3 million from 2006/07 to 2007/08.

Operating costs have increased by £9 million from 2006/07. This was primarily due to £9 million of provisions for various one-off operational costs. Depreciation and amortisation has reduced by £5 million, reflecting our shrinking asset base.

As a consequence of the above, operating profit reduced by £6 million.

Other activities

About other activities

Other activities comprises xoserve, which delivers transportation transactional services on behalf of all the major gas network transportation companies in Great Britain, including our Gas Transmission and Gas Distribution businesses, and corporate overheads that are not borne by individual businesses.

Performance during the year

Financial results

The results for other activities for the years ended 31 March 2008 and 2007 were as follows:

	Years ended 31 March	
	2008	2007
	£m	£m
Revenue	**38**	35
Operating costs excluding exceptional items	**(58)**	(68)
Adjusted operating loss	**(20)**	(33)
Exceptional items	**-**	-
Total operating loss	**(20)**	(33)

The revenue from other activities increased to £38 million from £35 million in 2006/07.

The operating cost of other activities fell from £68 million in 2006/07 to £58 million in 2007/08. This reduction was a result of a £17 million charge for employee related liabilities in 2006/07, which had previously been underwritten by another subsidiary of National Grid plc.

Financial position and financial management

Going concern

Having made enquiries, the Directors consider that the Company and its subsidiaries have adequate resources to continue in business for the foreseeable future and that it is therefore appropriate to adopt the going concern basis in preparing the consolidated and individual financial statements of the Company.

Financial position

Balance sheet

Our balance sheet at 31 March 2008 can be summarised as follows:

	Assets £m	Liabilities £m	Net assets £m
Property, plant and equipment and non-current intangible assets	9,813	-	9,813
Current assets and liabilities	396	(929)	(533)
Other non-current assets and liabilities	5,611	(1,108)	4,503
Deferred tax	-	(1,629)	(1,629)
Total before net debt	15,820	(3,666)	12,154
Net debt	752	(6,926)	(6,174)
Total as at 31 March 2008	16,572	(10,592)	5,980
Total as at 31 March 2007	15,478	(9,511)	5,967

The increase in net assets from £5,967 million at 31 March 2007 to £5,980 million at 31 March 2008 resulted from the profit for the year from continuing operations of £493 million and discontinued operations of £3 million, net income recognised directly in equity of £14 million and other changes in equity of £3 million, partly offset by dividends paid of £500 million.

Net debt

Net debt increased by £990 million from £5,184 million at 31 March 2007 to £6,174 million at 31 March 2008, as cash flows from operations of £1,327 million were exceeded by capital expenditure of £1,470 million, dividends paid of £500 million, the net interest charge of £376 million and other cash outflows of £10 million, less net increases in the value of derivatives of £39 million.

During 2007/08, bonds with a nominal value of £982 million and a fair value of £1,203 million plus accrued interest were transferred to the Company from National Grid Gas Holdings plc in return for repayment of inter-company loans.

At 31 March 2008, net debt comprised borrowings of £6,810 million and bank overdrafts of £6 million, less derivative financial instruments with a net carrying value of £119 million, cash and cash equivalents of £5 million and financial investments of £518 million (31 March 2007: borrowings of £5,717 million, bank overdrafts of £6 million and derivative financial instruments with a net carrying value of £15 million, less cash and cash equivalents of £174 million and financial investments of £380 million).

The maturity of borrowings is shown in note 18 to the consolidated financial statements.

Gearing

Gearing at 31 March 2008 and 31 March 2007, calculated as net debt at that date expressed as a percentage of net debt plus net assets shown in the balance sheet, amounted to 51% and 46% respectively. We do not consider that this standard gearing ratio is an appropriate measure as it does not reflect the economic value of the assets of our regulated businesses. For performance measurement purposes, we measure gearing on an adjusted basis, as described under financial performance on page 18.

Equity shareholders' funds

Equity shareholders' funds rose from £5,967 million at 31 March 2007 to £5,980 million at 31 March 2008. This increase was mainly explained by retained loss for the year to 31 March 2008 of £5 million and net other recognised income of £14 million, comprising net gains on hedges and tax thereon.

Liquidity and treasury management

Cash flow

Cash flows from our operations are largely stable over a period of years, but they do depend on the timing of customer payments. Our gas transmission and distribution operations are subject to multi-year price control agreements with our regulator, Ofgem. Significant changes in volumes, for example as a consequence of weather conditions, can affect cash flows in those businesses, with abnormally mild or cold weather driving volumes down or up respectively. Subject to this, we have essentially stable cash flows.

Cash flow forecasting

Both short- and long-term cash flow forecasts are produced frequently to assist in identifying our liquidity requirements. These forecasts, supplemented by a financial headroom position, are supplied to the Finance Committee of the Board of National Grid plc regularly to assess funding adequacy for at least a 12 month period. We also maintain committed facilities to support our liquidity requirements.

Credit facilities and unutilised commercial paper and medium term note programmes

At 31 March 2008, National Grid Gas plc had a $2.5 billion US commercial paper programme (unutilised), a $1.25 billion Euro commercial paper programme (unutilised) and a €10 billion Euro medium term note programme (€5.3 billion unissued).

We have both committed and uncommitted borrowing facilities that are available for general corporate purposes. At 31 March 2008, the Company had £0.8 billion of long-term committed facilities (undrawn) and around £0.4 billion of uncommitted borrowing facilities (undrawn).

Note 18 to the consolidated financial statements shows the maturity profile of undrawn committed borrowing facilities in sterling as at 31 March 2008.

Regulatory restrictions

As part of our regulatory arrangements, our operations are subject to a number of restrictions on the way we can operate. These include a regulatory 'ring-fence' that requires us to maintain adequate financial resources and restricts our ability to transfer funds or levy charges between the Company and other companies in the National Grid group of companies.

Treasury policy

The funding and treasury risk management for National Grid Gas is carried out on its behalf by a central department of National Grid operating under policies and guidelines approved by the Board of National Grid plc. The Finance Committee, a committee of the Board of National Grid plc, is responsible for regular review and monitoring of treasury activity and for approval of specific transactions, the authority for which may be delegated. National Grid plc has a Treasury function that raises funding and manages interest rate and foreign exchange rate risk for National Grid Gas.

There is a separate financing programme for National Grid Gas. The Finance Committees of both National Grid plc and of National Grid Gas approve all funding programmes.

The Treasury function is not operated as a profit centre. Debt and treasury positions are managed in a non-speculative manner, such that all transactions in financial instruments or products are matched to an underlying current or anticipated business requirement.

The use of derivative financial instruments is controlled by policy guidelines set by the Board of National Grid plc. Derivatives entered into in respect of gas commodities are used in support of the business' operational requirements and the policy regarding their use is explained below.

We had borrowings outstanding at 31 March 2008 amounting to £6,816 million (31 March 2007: £5,723 million).

We believe that the maturing amounts in respect of our contractual obligations can be met from existing cash and investments, operating cash flows and other refinancings that we reasonably expect to be able to secure in the future, together with the use of committed facilities if required. Our financial position and expected future operating cash flows are such that we can borrow on the wholesale capital and money markets and most of our borrowings are through public bonds and commercial paper.

We place surplus funds on the money markets, usually in the form of short-term fixed deposits and placements with money funds that are invested with approved banks and counterparties. Details relating to cash, short-term investments and other financial assets at 31 March 2008 are shown in notes 16 and 17 to the financial statements.

It is a condition of the regulatory ring-fence around the Company that it uses reasonable endeavours to maintain an investment grade credit rating. As of 31 March 2008, the long-term senior unsecured debt and short-term debt credit ratings respectively provided by Moody's, Standard & Poor's and Fitch were as follows:

Moody's	A3 / P2
Standard & Poor's	A- / A2
Fitch	A / F2

Standard & Poor's and Fitch have current outlooks of stable while Moody's has a current outlook of negative.

The main risks arising from our financial activities are set out below, as are the policies for managing these risks, which are agreed and reviewed by the Board of National Grid plc and the Finance Committee of that Board.

Refinancing risk management

The Board of National Grid plc controls refinancing risk mainly by limiting the amount of financing obligations (both principal and interest) arising on borrowings in any financial year. This policy is intended to prevent National Grid and its subsidiaries from having an excessively large amount of debt to refinance in a given time-frame.

During the year, we issued a mixture of short and long-term debt.

Note 18 to the consolidated financial statements sets out the contractual maturities of our borrowings over the next five years, with total contracted borrowings maturing over 45 years in compliance with our refinancing risk policy.

Interest rate risk management

Our interest rate exposure arising from borrowings and deposits is managed by the use of fixed and floating rate debt, interest rate swaps, swaptions and forward rate agreements. Our interest rate risk management policy is to seek to minimise total financing costs (being interest costs and changes in the market value of debt) subject to constraints so that, even with large movements in interest rates, neither the interest cost nor the total financing cost can exceed pre-set limits. Some of our bonds in issue are index-linked, that is their cost is linked to changes in the UK Retail Prices Index (RPI). We believe that these bonds provide a good hedge for revenues and our regulatory asset values that are also RPI-linked under our price control formulae.

The performance of the Treasury function in interest rate risk management is measured by comparing the actual total financing costs of our debt with those of a passively-managed benchmark portfolio. More information on the interest rate profile of our debt is included in note 30(a) to the consolidated financial statements.

Foreign exchange risk management

We have a policy of hedging certain contractually committed foreign exchange transactions over a prescribed minimum size. This covers a minimum of 75% of such transactions expected to occur up to six months in advance and a minimum of 50% of transactions six to twelve months in advance. Cover generally takes the form of forward sale or purchase of foreign currencies and must always relate to underlying operational cash flows.

In addition, we are exposed to currency exposures on borrowings in currencies other than sterling, principally the US dollar and the euro. This currency exposure is managed through the use of derivative financial instruments.

The currency compositions of financial liabilities and assets are shown in note 30(a) to the consolidated financial statements.

Counterparty risk management
Counterparty risk arises from the investment of surplus funds and from the use of derivative instruments. The Finance Committee of National Grid plc has agreed a policy for managing such risk, which is controlled through credit limits, approvals and monitoring procedures.

Further information is provided in note 30(b) to the consolidated financial statements.

Where multiple transactions are entered into with a single counterparty, a master netting arrangement is usually put in place to reduce our exposure to credit risk of that counterparty. At the present time, we use standard International Swap Dealers Association (ISDA) documentation, which provides for netting in respect of all transactions governed by a specific ISDA agreement with a counterparty, when transacting interest rate and exchange rate derivatives.

Derivative financial instruments held for purposes other than trading
As part of our business operations, we are exposed to risks arising from fluctuations in interest rates and exchange rates. We use financial instruments, including derivatives, to manage exposures of this type and they are a useful tool in managing risk. Our policy is not to use derivatives for trading purposes. Derivative transactions can, to varying degrees, carry both counterparty and market risk.

We enter into interest rate swaps to manage the composition of floating and fixed rate debt and so hedge the exposure of borrowings to interest rate movements. We also enter into foreign currency swaps to manage the currency composition of borrowings and so hedge the exposure to exchange rate movements. Certain agreements are combined foreign currency and interest rate swap transactions. Such agreements are known as cross-currency swaps.

We enter into forward rate agreements to hedge interest rate risk on short-term debt and money market investments. Forward rate agreements are commitments to fix an interest rate that is to be paid or received on a notional deposit of specified maturity, starting at a future specified date.

More details on derivative financial instruments are provided in notes 13 and 29 to the consolidated financial statements.

Valuation and sensitivity analysis
We calculate the fair value of debt and derivative instruments by discounting all future cash flows by the market yield curve at the balance sheet date. The market yield curve for each currency is obtained from external sources for interest and foreign exchange rates. In the case of instruments that include options, the Black's variation of the Black-Scholes model is used to calculate fair value.

The valuation techniques described above for interest rate swaps and currency swaps are a standard market methodology. These techniques do not take account of the credit quality of either party, but this is not considered to be a significant factor, unless there is a material deterioration in the credit quality of either party.

For debt and derivative instruments held, we utilise a sensitivity analysis technique to evaluate the effect that changes in relevant rates or prices will have on the market value of such instruments.

Details of the sensitivity of the income statement and equity to changes in the UK Retail Prices Index and UK interest rates are set out in note 30(d) to the consolidated financial statements. Under the assumptions set out in note 30(d), a 0.50% change in the UK Retail Prices Index would affect the income statement by £10 million after tax, but would have no effect on equity, while a 0.50% change in UK interest rates would affect the income statement by £5 million and equity by £12 million after tax.

Commodity contracts

Commodity derivatives
In the normal course of business, we are party to commodity derivatives. These have included gas futures, gas options and gas forwards that are used to manage commodity prices associated with our gas delivery operations. This includes the buying back of capacity rights already sold in accordance with our gas transporter licences and Uniform Network Code obligations.

These financial exposures are monitored and managed as an integral part of our financial risk management policy. At the core of this policy is a condition that we will engage in activities at risk only to the extent that those activities fall within commodities and financial markets to which we have a physical market exposure, in terms and volumes consistent with our core business. We do not issue, or intend to hold, derivative instruments for trading purposes, and hold such instruments consistent with our various licence and regulatory obligations.

Commodity trading
In our Gas Transmission operation we are obliged to offer for sale, through a series of auctions (both short- and long-term), a predetermined quantity of entry capacity for every day in the year at predefined locations. Where, on the day, the gas transmission system's capability is constrained, such that gas is prevented from entering the system for which entry capacity rights have been sold, then our Gas Transmission business is required to buy back those entry capacity rights sold in excess of system capability. Forward and option contracts are used to reduce the risk and exposure to on-the-day entry capacity prices.

Commitments and contingencies

Commitments and contingencies outstanding at 31 March 2008 and 2007 are summarised in the table below:

	2008	2007
	£m	£m
Future capital expenditure contracted but not provided for	**461**	753
Total operating lease commitments	**82**	68
Other commitments and contingencies	**84**	213

Information regarding obligations under pension and other post-retirement benefits is given below under the heading 'Retirement arrangements'.

We propose to meet all of our commitments from existing cash and investments, operating cash flows, existing credit facilities, future facilities and other financing that we reasonably expect to be able to secure in the future.

Details of material litigation as at 31 March 2008

We were not party to litigation that we considered to be material as at 31 March 2008.

As noted on page 6, Ofgem decided that we were guilty of breaches of competition law with respect to our metering services business in the UK and have imposed a fine of £41.6 million, which has been suspended pending our appeal to the Competition Appeal Tribunal. We believe that we have never been anti-competitive and that we will be successful in appealing this decision. We have therefore not provided for this fine in our financial statements.

Related party transactions

We provide services to and receive services from related parties, principally fellow subsidiaries of National Grid. In the year ended 31 March 2008, we charged £25 million and received charges of £116 million from related parties (other than Directors and key managers), compared with £51 million and £201 million respectively in 2006/07.

Further information relating to related party transactions is contained within note 27 to the consolidated financial statements. Details of key management compensation and amounts paid to Directors are included within notes 3(c) and 3(d) to the consolidated financial statements respectively.

Retirement arrangements

The substantial majority of our employees are members of the National Grid UK Pension Scheme, which is operated by Lattice Group plc, an intermediate holding company of National Grid Gas. We do not provide any other post-retirement benefits.

The scheme has both a defined benefit section, which is closed to new entrants, and a defined contribution section, which is offered to all new employees.

As there is no contractual arrangement or stated policy for charging the net defined benefit cost of the scheme to National Grid Gas, we account for the scheme as if it were a defined contribution scheme and do not recognise any share of the assets and liabilities of the scheme.

Actuarial position

The last completed full actuarial valuation of the Scheme was as at 31 March 2006. This concluded that the pre-tax funding deficit was £371 million in the defined benefit section on the basis of the funding assumptions. Employer cash contributions for the ongoing cost of the scheme are currently being made at a rate of 32.7% of pensionable payroll.

Contributions

The actuarial valuation of the Scheme as at 31 March 2007 is currently in progress, but has not yet been concluded. In advance of finalising the valuation, we have made deficit contributions of £114 million during 2007/08, which were reimbursed by Lattice Group plc, and a further £305 million to 31 May 2008, in addition to ongoing employer contributions. National Grid is currently in the process of agreeing a recovery plan with the trustees in respect of the deficit expected to be included in the valuation.

Accounting policies

Basis of accounting

The consolidated financial statements present our results for the years ended 31 March 2008 and 2007 and our financial position as at 31 March 2008 and 2007. They have been prepared using the accounting policies shown, in accordance with International Financial Reporting Standards (IFRS).

In complying with IFRS, we are also complying with the version of IFRS that has been endorsed by the European Union for use by listed companies.

IFRS differ from UK Generally Accepted Accounting Principles (UK GAAP).

Choices permitted under IFRS

Since 1 April 2005, we have presented our consolidated financial statements in accordance with IFRS. We were required to make a number of choices on the adoption of IFRS and in addition we continue to choose from certain options that are available within accounting standards.

The principal choices made on the adoption of IFRS, which cannot be changed, were as follows:

Transition date	Our opening IFRS balance sheet was established as at 1 April 2004. We used certain balances in our previous UK GAAP financial statements as the basis for our opening IFRS balance sheet.
Business combinations	Business combinations prior to 1 April 2004 were not changed retrospectively.
Carrying value of assets at transition	In most cases we used brought forward depreciated cost, as adjusted for changes in accounting policies to conform to IFRS, to be the opening carrying value under IFRS.
Share-based payments	We recognised all active share option grants retrospectively.
Cumulative translation differences	We chose to measure and present cumulative translation differences arising since 1 April 2004 only.

Significant choices that we continue to make on an ongoing basis include the following:

Presentation formats	We use the nature of expense method for our income statement and total our balance sheet to net assets and total equity. In the income statement, we present subtotals of total operating profit, profit before tax and profit from continuing operations, together with additional subtotals excluding exceptional items and remeasurements. Exceptional items and remeasurements are presented on the face of the income statement.
Pensions	We recognise transactions with the defined benefits section of the National Grid UK Pension Scheme as if it were a defined contribution scheme, and do not recognise any of the Scheme assets and liabilities or actuarial gains and losses.
Capitalised interest	We capitalise interest into the cost of assets that we construct where the conditions of IAS 23 are met.
Capital contributions	Contributions received towards capital expenditure are recorded as deferred income and amortised in line with the depreciation on the associated asset.
Financial instruments	We normally opt to apply hedge accounting in most circumstances where this is permitted.
Individual accounts	We have chosen to continue to use UK GAAP, rather than IFRS, in the individual financial statements of National Grid Gas plc and of its UK subsidiary companies.

Accounting standards and interpretations adopted in 2007/08

In preparing our consolidated financial statements we have complied with International Financial Reporting Standards, International Accounting Standards and interpretations applicable for 2007/08. The following amendments to standards and interpretations were adopted during 2007/08, none of which resulted in a material change to our consolidated results, assets or liabilities in 2007/08 or in those of previous periods:

New interpretations	IFRIC 8, IFRIC 9, IFRIC 10 and IFRIC 11 contain guidance on accounting for share-based exchange transactions, embedded derivatives, impairments in half yearly reports and share-based payments. Implementation of these interpretations did not have a material impact on our results, assets or liabilities.

Segmental reporting

In addition to presenting the consolidated financial results and financial position in the financial statements, we provide a breakdown of those results and balances into our business segments. The presentation of segment information is based on management responsibilities that existed at 31 March 2008 and the external and regulatory environments in which we operate. Our business segments are Gas Transmission, Gas Distribution and Gas Metering, with other operations and corporate activities aggregated within other activities. Geographical segments are not reported, as our activities are all within the UK. Discontinued operations comprise amounts in respect of the four gas distribution networks sold on 1 June 2005.

Gas transportation transaction services undertaken by our subsidiary xoserve, which were presented as part of the Gas Distribution segment in the 2006/07 Annual Report and Accounts, are now reported within other activities, in line with the current management structure.

Critical accounting policies

The application of accounting principles requires us to make estimates, judgments and assumptions that may affect the reported amounts of assets, liabilities, revenue and expenses and the disclosure of contingent assets and liabilities in the accounts. On an ongoing basis, we evaluate our estimates using historical experience, consultation with experts and other methods that we consider reasonable in the particular circumstances to ensure compliance with IFRS. Actual results may differ significantly from our estimates, the effect of which will be recognised in the period in which the facts that give rise to the revision become known.

Certain accounting policies have been identified as critical accounting policies, as these policies involve particularly complex or subjective decisions or assessments. The discussion of critical accounting policies below should be read in conjunction with the description of our accounting policies set out in our consolidated financial statements.

Our critical accounting policies and accounting treatments are considered to be:

Estimated economic lives of property, plant and equipment	The reported amounts for depreciation of property, plant and equipment can be materially affected by the judgments exercised in determining their estimated economic lives. Depreciation amounted to £418 million in 2007/08 and £391 million in 2006/07.
Carrying value of assets and potential for impairments	The carrying value of assets recorded in the consolidated balance sheet could be materially reduced if an impairment were to be assessed as being required. Our total assets at 31 March 2008 were £16,572 million, including £9,753 million of property, plant and equipment, £60 million of intangible assets and £5,611 million owed by National Grid Gas's immediate parent undertaking (31 March 2007: £15,478 million, £8,817 million, £44 million and £5,614 million respectively). Impairment reviews are carried out when a change in circumstance is identified that indicates an asset might be impaired. An impairment review involves calculating either or both of the fair value or the value-in-use of an asset or group of assets and comparing with the carrying value in the balance sheet. These calculations involve the use of assumptions as to the price that could be obtained for, or the future cash flows that will be generated by, an asset or group of assets, together with an appropriate discount rate to apply to those cash flows.
Revenue	Revenue includes an assessment of transportation services supplied to customers between the date of the last invoice and the year end. Changes to the estimate of the transportation services supplied during this period would have an impact on our reported results. Our estimates of unbilled revenues amounted to £142 million at 31 March 2008 compared with £130 million at 31 March 2007.
Assets and liabilities carried at fair value	Certain financial investments and derivative financial instruments are carried in the balance sheet at their fair value rather than historical cost. The fair value of financial investments is based on market prices, as are those of derivative financial instruments where market prices exist. Other derivative financial instruments are valued using financial models, which include judgements on, in particular, future movements in exchange and interest rates.
Hedge accounting	We use derivative financial instruments to hedge certain economic exposures arising from movements in exchange and interest rates or other factors that could affect either the value of our assets or liabilities or affect our future cash flows. Movements in the fair values of derivative financial instruments may be accounted for using hedge accounting where we meet the relevant eligibility, documentation and effectiveness testing requirements. If a hedge does not meet the strict criteria for hedge accounting, or where there is ineffectiveness or partial ineffectiveness, then the movements will be recorded in the income statement immediately instead of being recognised in the statement of recognised income and expense or by being offset by adjustments to the carrying value of debt.
Pensions	Defined benefit pension obligations are accounted for as if the National Grid UK Pension Scheme were a defined contribution scheme as there is neither a contractual arrangement, nor a stated policy under which the Company is charged for the costs of providing pensions. A change in these arrangements may lead to the Company recognising the cost of providing pensions on a different basis, together with a proportion of the actuarial gains and losses and of the assets and liabilities of the pension scheme.
Exceptional items and remeasure-ments	Exceptional items and remeasurements are items of income and expenditure that, in the judgment of management, should be disclosed separately on the basis that they are material, either by their nature or their size, to an understanding of our financial performance and distort the comparability of financial performance between periods. Items of income or expense that are considered by management for designation as exceptional items include such items as significant restructurings, write-downs or impairments of non-current assets, material changes in environmental provisions, gains or losses on disposals of businesses or investments. Remeasurements comprise gains or losses recorded in the income statement arising from changes in the fair value of derivative financial instruments. These fair values increase or decrease as a consequence of changes in financial indices and prices over which we have no control.

Provisions	Provisions are made for liabilities that are uncertain in estimate. These include provisions for the cost of environmental restoration and remediation, restructuring and employer and public liability claims. Calculations of these provisions are based on estimated cash flows relating to these costs, discounted at an appropriate rate where the impact of discounting is material. The total costs and timing of cash flows relating to environmental liabilities are based on management estimates supported by the use of external consultants. At 31 March 2008, we have recorded provisions totalling £116 million (2007: £106 million), including £44 million (2007: £44 million) in respect of environmental liabilities.
Tax estimates	Our tax charge is based on the profit for the year and tax rates in effect, but we do not recognise current year transfer pricing adjustments which are expected to be settled through use of group relief. The determination of appropriate provisions for taxation requires us to take into account anticipated decisions of tax authorities and estimate our ability to utilise tax benefits through future earnings and tax planning. Our estimates and assumptions may differ from future events.

In order to illustrate the impact that changes in assumptions could have on our results and financial position, the following sensitivities are presented:

Asset useful lives	An increase in the useful economic lives of assets of one year on average would reduce our annual depreciation charge on property, plant and equipment by £13 million (before tax).
Revenue accruals	A 10% change in our estimate of unbilled revenues at 31 March 2008 would result in an increase or decrease in our recorded net assets and profit for the year by approximately £9 million net of tax.
Assets carried at fair value	A 10% change in assets and liabilities carried at fair value would result in an increase or decrease in the carrying value of derivative financial instruments of £12 million.
Hedge accounting	If the gains and losses arising on derivative financial instruments during the year ended 31 March 2008 had not achieved hedge accounting then the profit for the year would have been £38 million lower than that reported net of tax and net assets would have been £28 million higher.
Provisions	A 10% change in the estimates of future cash flows estimated in respect of provisions for liabilities would result in an increase or decrease in net assets of approximately £11 million.

Accounting developments

Forthcoming changes in IFRS

The following accounting standards and interpretations have not yet been adopted, but are expected to be adopted in future periods:

Segment reporting	IFRS 8 changes the reporting requirements for segmental reporting and will apply with effect from 1 April 2009. If IFRS 8 had been adopted in 2007/08, there would have been no change in business segments reported. However, we would not have had to report on geographical segments.
Borrowing costs	An amendment to IAS 23 on borrowing costs will require interest to be capitalised into the cost of assets under construction. We already follow this policy and so this will have no impact.
Service concessions	IFRIC 12 on service concessions, to be adopted from 1 April 2008, requires assets operated on behalf of a public authority as a concession, where the asset reverts back to the public authority at the conclusion of the arrangement, to be recognised as a financial or intangible asset depending on whether income is recovered from the public authority or from users. We do not operate any concessions of this type and so this will have no impact.
Customer loyalty programmes	IFRIC 13, effective from 1 April 2008, requires the sale of goods or services and associated loyalty programmes to be accounted for as multi-element transactions. The separate elements will have to be fair valued and consideration allocated accordingly, which would defer recognition of an element of revenue. We do not have any loyalty programmes of this nature and so this will have no impact.
Pension assets and minimum funding	IFRIC 14, on when net pension assets can be recognised in the balance sheet and on how to account for minimum funding requirements, will apply with effect from 1 April 2008. In certain circumstances, the recognition of an accounting surplus in a pension plan as an asset on the balance sheet may be restricted, or provision may be required for minimum funding requirements in excess of pension obligations recognised in the balance sheet. We do not recognise any net pension assets or obligations in our balance sheet and so this will have no impact.
Presentation of financial statements	Amendment to IAS 1, effective 1 April 2009, changes the presentation of financial information, but does not affect the amounts of reported earnings or assets and liabilities. The principal changes are: the statement of recognised income and expense must immediately follow the income statement and must include separate tax disclosure on each gain or loss recognised outside the income statement; the statement of changes in equity will be presented as a primary statement; and there will be an option to rename the primary statements. This will have a significant impact on the presentation of the 2009/10 financial statements as described above. However, there will be no impact on our results, assets or liabilities.

Business combinations	IFRS 3 (revised), expected to be adopted 1 April 2010, makes a number of changes to business combination accounting including: consideration payments fair valued at acquisition date; subsequent consideration payments at fair value through the income statement; changes to calculation of goodwill; and all transaction costs expensed. IFRS 3 (revised) will be implemented prospectively and so will affect future business combinations, possibly materially compared with how they are accounted for under current standards. However, this change will have no impact on our current results, assets or liabilities.
Non-controlling interests	IAS 27 (revised), expected to be adopted in 2010, requires transactions with non-controlling (minority) interests to be recorded in equity. We do not have any material non-controlling interests and so this change will have no material impact.
Share based payments	This amendment to IFRS 2, expected to be adopted 1 April 2009, clarifies the definition of vesting conditions and changes the accounting for cancellations. For cancellation, rather than reversing the previous expense, any remaining expense will be accelerated. This will affect the way we account for our Save as You Earn share schemes, but due to the low levels of cancellations by employees in the past, we do not anticipate that this is likely to have a material impact on future results.
Financial instrument presentation	Amendments to IAS 32 and IAS 1 require certain puttable financial instruments, which impose an obligation to deliver a pro-rata share of net assets on liquidation, to be classified as liabilities. We currently have no such instruments and so this will have no impact.

Directors' Report

for the year ended 31 March 2008

In accordance with the requirements of the Companies Acts and UK Listing Authority's Listing, Disclosure and Transparency Rules, the following sections describe the matters that are required for inclusion in the Directors' Report and were approved by the Board. Further details of matters required to be included in the Directors' Report are incorporated by reference into this report, as detailed below.

Directors

The Directors serving as at the date of this report were:

Andy Chapman	Appointed June 2007
Malcolm Cooper	Appointed June 2007
Mark Fairbairn	Appointed June 2003
Paul Whittaker	Appointed June 2007
Nick Winser	Appointed July 2003
Adam Wiltshire	Appointed July 2006

Steve Holliday, Steve Lucas and Chris Murray also served as Directors during the period, resigning on 27 June 2007.

Directors' and Officers' liability insurance cover is arranged and qualifying third party indemnities are in place for each Director.

Principal activities and business review

A full description of the Company's principal activities, businesses and principal risks and uncertainties is contained in the Operating and Financial Review on pages 1 to 33, which are incorporated by reference into this report.

Material interests in shares

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

Dividends

During the year, two interim dividends totalling £500 million were paid (2007: £350 million interim dividend and £1,500 million final dividend in respect of 2005/06). The Directors have not proposed a final dividend.

Donations

During 2007/08, some £3.0 million was invested in support of community initiatives and relationships in the UK, including direct charitable donations of £0.4 million (2007: £0.7 million).

No donations were made in the UK and EU for the purposes of the Political Parties, Elections and Referendums Act 2000.

Research and development

Expenditure on research and development was £2.1 million during the year (2007: £1.5 million).

Financial instruments

Details on the use of financial instruments and financial risk management are included on pages 28 to 29 in the Operating and Financial Review.

Disability

Through National Grid's inclusion and diversity programme, National Grid Gas remains committed to fair treatment of people with disabilities in relation to job applications, training, promotion and career development. Every effort is made to find appropriate alternative jobs for those who are unable to continue in their existing job due to disability.

Employee involvement

National Grid Gas, as a part of National Grid, has well established and effective arrangements through electronic mail, intranet and in-house publications and briefing meetings, at each business location and company wide, for communication and consultation with both employees and trade union representatives, and for communication of performance, strategy and operating model, together with significant business issues.

National Grid Gas recognises the importance of aligning employee and shareholder interests, and is committed to employee share ownership through the National Grid plc Share Incentive Plan and Sharesave scheme, which are open to all employees.

Policy and practice on payment of creditors

It is the Company's policy to include in contracts or other agreements, terms of payment with suppliers. Once agreed, the Company aims to abide by these terms of payment.

The average creditor payment period at 31 March 2008 was 22 days (23 days at 31 March 2007).

Audit information

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

Annual General Meeting

Notice of the Company's Annual General Meeting for 2008 will be issued separately to shareholders.

On behalf of the Board

Helen Mahy

Company Secretary, 5 June 2008

National Grid Gas plc, 1-3 Strand London WC2N 5EH
Registered in England and Wales No. 2006000

Contents of financial statements

Directors' statement and independent auditors' report

Consolidated financial statements under IFRS

Basis of preparation

Primary statements

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

Notes to the consolidated financial statements – supplementary information

Company financial statements under UK GAAP

Basis of preparation

Primary statement

Notes to the Company financial statements

Statement of Directors' responsibilities

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union, and the Company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice). In preparing the consolidated financial statements, the directors have also elected to comply with IFRS, issued by the International Accounting Standards Board (IASB).The consolidated financial statements and Company financial statements are required by law to give a true and fair view of the state of affairs of the Company on a consolidated and individual basis and of the consolidated profit of the Company for that period.

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

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

The Directors confirm that they have complied with the above requirements in preparing both the consolidated financial statements and the Company financial statements. They also confirm that the annual report includes a fair review of the development and performance of the business together with a description of the principal risks and uncertainties faced by the Company.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company on a consolidated and individual basis and to enable them to ensure that the consolidated financial statements comply with the Companies Act 1985 and Article 4 of the IAS Regulation and the Company financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and its subsidiaries and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for ensuring that publication of financial statements on the website of the Company or of a related company is in accordance with UK legislation and for maintenance and integrity of that website. Legislation in other jurisdictions governing the preparation and dissemination of financial statements may differ from UK legislation.

By order of the Board

Helen Mahy
Company Secretary
5 June 2008

Independent Auditors' report to the Members of National Grid Gas plc

We have audited the consolidated and Company financial statements (the "financial statements") of National Grid Gas plc for the year ended 31 March 2008, which comprise the consolidated income statement, the consolidated and Company balance sheets, the consolidated cash flow statement, the consolidated statement of recognised income and expense, the Accounting policies and Company accounting policies, the Adoption of new accounting standards, the Notes to the consolidated financial statements and the Notes to the Company financial statements. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of Directors and auditors
The Directors' responsibilities for preparing the Annual Report and the consolidated financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and for preparing the Company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985 and whether, in addition, the consolidated financial statements have been properly prepared in accordance with Article 4 of the IAS Regulation. We also report to you whether, in our opinion, the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Operating and Financial Review that is cross-referred from the principal activities and business review section of the Directors' Report.

In addition, we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the items listed in the contents section of the Annual Report, excluding the 2008 audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion
In our opinion:

- the consolidated financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Group's affairs as at 31 March 2008 and of its profit and cash flows for the year then ended;
- the consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- the Company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 March 2008;
- the Company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Birmingham
5 June 2008

Accounting policies

for the year ended 31 March 2008

A. Basis of preparation of consolidated financial statements under IFRS

National Grid Gas's principal activities involve the transmission and distribution of gas and the provision of gas metering services within Great Britain. The Company is a public limited company incorporated and domiciled in England with its registered office at 1-3 Strand, London WC2 5EH.

These consolidated financial statements were approved for issue by the Board of Directors on 5 June 2008.

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board and as adopted by the European Union. They are prepared on the basis of all IFRS accounting standards and interpretations that are mandatory for periods ending 31 March 2008 and in accordance with the Companies Act 1985 applicable to companies reporting under IFRS and Article 4 of the European Union IAS regulation. The 2007 comparative financial information has also been prepared on this basis.

The consolidated financial statements have been prepared on a historical cost basis, except for the revaluation of certain financial instruments.

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

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

B. Basis of consolidation

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

A subsidiary is defined as an entity controlled by the Company. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Where necessary, adjustments are made to bring the accounting policies used under UK generally accepted accounting principles (UK GAAP) or other framework used in the individual financial statements of the Company and its subsidiaries into line with those used by the Company in its consolidated financial statements under IFRS. Inter-company transactions are eliminated.

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

C. Foreign currencies

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

Gains and losses arising on retranslation of monetary assets and liabilities are included in the income statement.

On consolidation, the assets and liabilities of overseas financing operations that have a functional currency different from the Company's functional currency of sterling are translated at exchange rates prevailing at the balance sheet date. Income and expense items are translated at the weighted average exchange rates for the period. Exchange differences arising are classified as equity and transferred to the consolidated translation reserve.

D. Intangible assets

Identifiable intangible assets are recorded at cost less accumulated amortisation and any provision for impairment.

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

Intangible assets under development are not amortised. Other non-current intangible assets are amortised on a straight-line basis over their estimated useful economic lives. The principal amortisation periods for categories of intangible assets are:

Amortisation periods	Years
Software	3 to 5

Intangible emission allowances are accounted for in accordance with accounting policy T.

E. Property, plant and equipment

Property, plant and equipment is recorded at cost or deemed cost at the date of transition to IFRS, less accumulated depreciation and any impairment losses.

Cost includes payroll and finance costs incurred which are directly attributable to the construction of property, plant and equipment.

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

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

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

Depreciation is not provided on freehold land or assets in the course of construction. Other property, plant and equipment are depreciated, principally on a straight-line basis, at rates estimated to write off their book values over their estimated useful economic lives. In assessing estimated useful economic lives, which are reviewed on a regular basis, consideration is given to any contractual arrangements and operational requirements relating to particular assets. Unless otherwise determined by operational requirements, the depreciation periods for the principal categories of property, plant and equipment are, in general, as shown in the table below:

Depreciation periods	Years
Freehold and leasehold buildings	up to 50
Plant and machinery	
– mains, services and regulating equipment	30 to 100
– meters and metering equipment	5 to 18
Motor vehicles and office equipment	3 to 10

F. Impairment of assets

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

Recoverable amount is defined as the higher of fair value less costs to sell and estimated value in use at the date the impairment review is undertaken.

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

Tests for impairment are carried out only if there is some indication that the carrying value of the assets may have been impaired.

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

G. Taxation

Current tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

Current tax assets and liabilities arising from transfer pricing adjustments, which are expected to be fully recovered through group relief, are initially recognised when tax returns are submitted to the tax authorities.

Deferred tax

Deferred tax is provided using the balance sheet liability method and is recognised on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit.

Deferred tax liabilities are generally recognised on all taxable temporary differences and deferred tax assets are recognised to the extent that is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition (other than a business combination) of assets and liabilities in a transaction that affects neither the accounting profits nor the taxable profits.

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

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based on the tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. Deferred tax is charged or credited to the income statement, except where it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the deferred income tax asset to be recovered. Unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that is has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are offset when there is a legally enforceable right exists to set off current tax assets against current tax liabilities, when they relate to income taxes levied by the same taxation authority and it is intended to settle current tax asset and liabilities on a net basis.

H. Discontinued operations

Cash flows and operations that relate to a major component of the business or geographical region that has been sold are shown separately from continuing operations.

I. Inventories

Inventories, which comprise raw materials and consumables, are stated at cost less provision for damage and obsolescence. Cost comprises acquisition cost and those costs that have been incurred in bringing the inventories to their present location and condition.

J. Environmental costs

Provision is made for environmental costs, based on future estimated expenditures, discounted to present values. Changes in the provision arising from revised estimates or discount rates or changes in the expected timing of expenditures are recognised in the income statement. The unwinding of the discount is included within the income statement as a financing charge.

K. Revenue

Revenue represents the sales value derived from the transmission and distribution of gas and the provision of gas metering services during the year. It excludes value added tax and intra-group sales.

The sales value for the transmission and distribution of gas is largely determined from the amount of system capacity sold for the year and the amount of gas transported in the year, evaluated at contractual prices on a monthly basis. Where revenue for the year exceeds the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over-recovery, a liability for the over-recovery is not recognised as such an adjustment to future prices relates to the provision of future services. Similarly, an asset is not recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under-recovery.

The sales value for the provision of gas metering services is largely derived from monthly contractual charges for the provision of individual meters under long-term contractual arrangements.

L. Segmental information

Segmental information is presented in accordance with the management responsibilities and economic characteristics, including consideration of risks and returns, of business activities. The Company assesses the performance of its businesses principally on the basis of operating profit before exceptional items and remeasurements. The primary reporting format is by business. As all of our operations are within the same geographical area, Great Britain, no secondary reporting format is presented.

M. Pensions

The substantial majority of National Grid Gas's employees are members of the defined benefit section of the National Grid UK Pension Scheme. There is no contractual arrangement or stated policy for charging the net defined benefit cost of the Scheme to National Grid Gas. Accordingly, the Scheme is recognised as if it were a defined contribution scheme. The pension charge for the year represents the contributions payable to the Scheme for the period and a share of the assets and liabilities, or the actuarial gains and losses of the Scheme are not recognised.

N. Leases

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

O. Financial instruments

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

Trade receivables are initially recognised at fair value and subsequently measured at amortised cost, less any appropriate allowances for estimated irrecoverable amounts. A provision is established for irrecoverable amounts when there is objective evidence that amounts due under the original payment terms will not be collected. Indications that the trade receivable may become irrecoverable would include financial difficulties of the debtor, likelihood of the debtor's insolvency, and default or significant failure of payment. Trade payables are initially recognised at fair value and subsequently measured at amortised cost.

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

Other financial investments are recognised at fair value plus directly related incremental transaction costs and are subsequently carried at fair value on the balance sheet. Changes in the fair value of investments classified as available-for-sale are recognised directly in equity, until the investment is disposed of or is determined to be impaired. At this time, the cumulative gain or loss previously recognised in equity is included in the net profit or loss for the period. Investment income on investments classified as available-for-sale is recognised on an effective interest rate basis and taken through interest income in the income statement.

Borrowings, which include interest-bearing loans, UK retail price index (RPI) linked debt and overdrafts, are recorded at their initial fair value which normally reflects the proceeds received, net of direct issue costs less any repayments. Subsequently they are stated at amortised cost, using the effective interest rate method. Any difference between the proceeds after direct issue costs and the redemption value is recognised over the term of the borrowing in the income statement using the effective interest rate method.

Borrowing costs directly attributable to the acquisition, construction or development of qualifying assets (being assets that necessarily take a substantial period of time to get ready for their intended use) are added to their cost. Such additions cease when the assets are substantially ready for their intended use.

Where we have derivatives embedded in financial instruments or other contracts that are closely related to those instruments or host contracts, no adjustment is made with respect to such derivative clauses. In particular, interest payments on UK RPI debt are linked to movements in the UK retail price index. The link to RPI is considered to be an embedded derivative, which is closely related to the underlying debt instrument based on the view that there is a strong relationship existing between interest rates and inflation in the UK economy. Consequently, these embedded derivatives are not accounted for separately from the debt instrument.

An equity instrument is any contract that evidences a residual interest in the consolidated assets of the Company after deducting all of its liabilities and is recorded at the proceeds received, net of direct issue costs with an annual amount equal to the nominal amount of the shares issued included in the share capital account and the balance recorded in the share premium account.

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

P. Hedge accounting

The Company and its subsidiaries enter into both derivative financial instruments (derivatives) and non-derivative financial instruments in order to manage interest rate and foreign currency exposures, and commodity price risks associated with underlying business activities and the financing of those activities.

Hedge accounting allows derivatives to be designated as a hedge of another (non-derivative) financial instrument, to mitigate the impact of potential volatility in the income statement of changes in fair value of the derivative instruments. To qualify for hedge accounting documentation is prepared specifying the hedging strategy, the component transactions and methodology used for effectiveness measurement. The Company uses two hedge accounting methods.

Firstly, changes in the carrying value of financial instruments that are designated and effective as hedges of future cash flows (cash flow hedges) are recognised directly in equity and any ineffective portion is recognised immediately in the income statement. Amounts deferred in equity in respect of cash flow hedges are subsequently recognised in the income statement in the same period in which the hedged item affects net profit or loss. Where a non-financial asset or a non-financial liability results from a forecasted transaction or firm commitment being hedged, the amounts deferred in equity are included in the initial measurement of that non-monetary asset or liability.

Secondly, fair value hedge accounting offsets the changes in the fair value of the hedging instrument against the change in the fair value of the hedged item in respect to the risk being hedged. These changes are recognised in the income statement to the extent the fair value hedge is effective. Adjustments made to the carrying amount of the hedged item for fair value hedges will be amortised over the remaining life, in line with the hedged item.

Changes in the fair value of derivatives that do not qualify for hedge accounting are recognised in the income statement as they arise, within finance costs.

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

If a hedged forecast transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement immediately.

Q. Share-based payments

National Grid issues equity-settled share-based payments to certain employees of the Company and its subsidiaries.

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

R. Business performance and exceptional items and remeasurements

Our financial performance is analysed into two components: business performance, which excludes exceptional items and remeasurements; and exceptional items and remeasurements.

Business performance is used by management to monitor financial performance, as it is considered to increase the comparability of our reported financial performance from year to year. Business performance subtotals, which exclude exceptional items and remeasurements, are presented on the face of the income statement or in the notes to the financial statements.

Exceptional items and remeasurements are items of income and expenditure that, in the judgment of management, should be disclosed separately on the basis that they are material, either by their nature or their size, to an understanding of our financial performance and significantly distort the comparability of financial performance between periods.

Items of income or expense that are considered by management for designation as exceptional items include such items as significant restructurings, write-downs or impairments of non-current assets, significant changes in environmental provisions, and gains or losses on disposals of businesses or investments.

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

Remeasurements comprise gains or losses recorded in the income statement arising from changes in the fair value of derivative financial instruments to the extent that hedge accounting is not achieved or is not effective.

S. Other operating income

Other operating income primarily relates to profits or losses arising on the disposal of properties arranged by National Grid's property management business, which is considered to be part of normal recurring operating activities, and income from the sale of emission allowances.

T. Emission allowances

Emission allowances, which relate to the emissions of carbon dioxide, are recorded as an intangible asset within current assets and are initially recorded at cost, and subsequently at the lower of cost and net realisable value. For allocations of emission allowances granted by the UK Government, cost is deemed to be equal to fair value at the date of allocation. Receipts of such grants are treated as deferred income and are recognised in the income statement in the period in which carbon dioxide emissions are made. A provision is recorded in respect of the obligation to deliver emission allowances and charges are recognised in the income statement in the period in which carbon dioxide emissions are made.

Income from the sale of emission allowances is reported as part of other operating income.

U. Cash and cash equivalents

Cash and cash equivalents include cash held at bank and in hand, together with short-term highly liquid investments with an original maturity of less than three months that are readily convertible to known amounts of cash and subject to an insignificant change in value and bank overdrafts, which are reported in borrowings.

V. Other reserves

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

W. Dividends

Dividends are recognised in the financial year in which they are approved.

X. Areas of judgement and key sources of estimation uncertainty

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

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

- The categorisation of certain items as exceptional items and remeasurements and the definition of adjusted earnings – note 4.
- The exemptions adopted on transition to IFRS on 1 April 2004.
- The non-recognition of certain net current tax liabilities expected to arise from transfer pricing adjustments – accounting policy G.
- The recognition of defined benefit pension costs as if the National Grid UK Pension Scheme was a defined contribution scheme – accounting policy M.
- Hedge accounting – accounting policy P.

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

- Review of residual lives, carrying values and impairment charges for intangible assets and property, plant and equipment – accounting policies D, E and F.
- Valuation of financial instruments and derivatives – notes 13, 16 and 29.
- Revenue recognition and assessment of unbilled revenue – accounting policy K.
- Environmental provisions – note 22.

Adoption of new accounting standards

New IFRS accounting standards and interpretations adopted in 2007/08

During the year ended 31 March 2008, the Company adopted the following amendments to International Financial Reporting Standards (IFRS), International Accounting Standards (IAS) and the International Financial Reporting Interpretation Committee pronouncements (IFRIC). None of these had a material impact on consolidated results or assets and liabilities.

IFRIC 8 on share-based payments	Addresses the issue of whether IFRS 2 'Share-based Payment' applies to transactions in which the entity cannot identify specifically some or all of the goods or services received.
IFRIC 9 on the reassessment of embedded derivatives	Prohibits reassessment of the treatment of embedded derivatives subsequent to initial recognition unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required.
IFRIC 10 on interim financial reporting and impairment	States that any impairment losses on goodwill and certain financial assets recognised in an interim financial statement may not be reversed in subsequent interim or annual financial statements.
IFRIC 11 on group and treasury share transactions	Provides guidance on whether share-based transactions involving treasury shares or involving subsidiary undertakings (for instance, options over a parent's shares) should be accounted for as equity-settled or cash-settled, share-based payment transactions.

New IFRS accounting standards and interpretations not yet adopted

The Company has yet to adopt the following standards and interpretations, but these are not expected to have a material impact on consolidated results or assets and liabilities. Further information is provided in the accounting policies section of the Operating and Financial Review.

IFRS 8 on operating segments	Sets out the requirements for the disclosure of information about an entity's operating segments and about the entity's products and services, the geographical areas in which it operates and its major customers. IFRS 8 is required to be adopted on 1 April 2009.
Amendment to IAS 23 on borrowing costs	Removes the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. The amendment to IAS 23 is required to be adopted on 1 April 2009.
IFRIC 12 on service concession arrangements	Applies to contractual arrangements whereby a private sector operator participates in the development, financing, operation and maintenance of infrastructure for public sector services, for example, under private finance initiative (PFI) contracts. IFRIC 12 will be adopted on 1 April 2008.
IFRIC 13 on customer loyalty programmes	Clarifies that the sale of goods or services together with customer award credits (for example, loyalty points or the right to free products) is accounted for as a multiple-element transaction. The consideration received from the customer is allocated between the components of the arrangement based on their fair values, which will defer the recognition of some revenue. IFRIC 13 will be adopted on 1 April 2008.
IFRIC 14 on defined benefit assets and minimum funding requirements	Considers the limit on the measurement of a defined benefit asset to the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan plus unrecognised gains and losses, as set out in IAS 19 'Employee Benefits'. The interpretation considers when refunds or reductions in future contributions should be considered available, particularly when a minimum funding requirement exists. IFRIC 14 will be adopted on 1 April 2008.
Amendment to IAS 1 on the presentation of financial statements	Requires changes to the presentation of financial statements and adopts revised titles for the primary statements, although companies may continue to use the existing titles. It is expected that the amendment to IAS 1 will be adopted on 1 April 2009.
IFRS 3R on business combinations	Makes a number of changes to the accounting for business combinations, including requirements that all payments to purchase a business are to be recorded at fair value at the acquisition date, with some contingent payments subsequently remeasured at fair value through income; an option to calculate goodwill based on the parent's share of net assets only or to include goodwill related to the minority interest; and a requirement that all transaction costs be expensed. It is expected that IFRS 3R will be adopted on 1 April 2010.
IAS 27R on consolidated and individual financial statements	Requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control. The revised standard also specifies the accounting when control is lost. It is expected that IAS 27R will be adopted on 1 April 2010.
Amendment to IFRS 2 on share-based payments	Clarifies the definition of vesting conditions and the accounting treatment of cancellations. Vesting conditions are defined as either service conditions or performance conditions. Cancellations by employees are accounted for in the same way as cancellations by the company. It is expected that the amendment to IFRS 2 will be adopted on 1 April 2009.
Amendments to IAS 32 and IAS 1 on puttable financial instruments and obligations arising on liquidation	Addresses the classification as a liability or as equity of certain puttable financial instruments and instruments, or components thereof, which impose upon an entity an obligation to deliver a pro rata share of net assets on liquidation. The amendment to IAS 32 and IAS 1 are required to be adopted on 1 April 2009.

Consolidated income statement

for the years ended 31 March

	Notes	2008 £m	2008 £m	2007 £m	2007 £m
Revenue	1(a)		**2,440**		2,199
Other operating income	2		**8**		-
Operating costs	3		**(1,477)**		(1,421)
Operating profit					
Before exceptional items	1(b)	**994**		792	
Exceptional items	4	**(23)**		(14)	
Total operating profit	1(b)		**971**		778
Interest income and similar income	6		**16**		10
Interest expense and other finance costs					
Before exceptional items and remeasurements	6	**(357)**		(253)	
Exceptional items and remeasurements	4, 6	**24**		(28)	
	6		**(333)**		(281)
Profit before taxation					
Before exceptional items and remeasurements		**653**		549	
Exceptional items and remeasurements		**1**		(42)	
Total profit before taxation			**654**		507
Taxation					
Before exceptional items and remeasurements	7	**(278)**		(239)	
Exceptional items and remeasurements	4, 7	**117**		7	
Total taxation	7		**(161)**		(232)
Profit from continuing operations after taxation					
Before exceptional items and remeasurements		**375**		310	
Exceptional items and remeasurements	4	**118**		(35)	
Profit for the year from continuing operations			**493**		275
Profit for the year from discontinued operations					
Exceptional items	8		**3**		13
Profit for the year			**496**		288
Attributable to:					
Equity shareholders of the parent			**495**		287
Minority interests			**1**		1
			496		288

The notes on pages 50 to 80 form part of the consolidated financial statements.

Consolidated balance sheet

at 31 March

	Notes	**2008** **£m**	2007 £m
Non-current assets			
Intangible assets	10	**60**	44
Property, plant and equipment	11	**9,753**	8,817
Other non-current assets	12	**5,611**	5,614
Derivative financial assets	13	**139**	76
Total non-current assets		**15,563**	14,551
Current assets			
Inventories and current intangible assets	14	**31**	30
Trade and other receivables	15	**365**	333
Financial investments	16	**518**	380
Derivative financial assets	13	**90**	10
Cash and cash equivalents	17	**5**	174
Total current assets		**1,009**	927
Total assets	1(d)	**16,572**	15,478
Current liabilities			
Borrowings	18	**(1,284)**	(1,891)
Derivative financial liabilities	13	**(27)**	(14)
Trade and other payables	19	**(851)**	(903)
Current tax liabilities		**(27)**	(40)
Provisions	22	**(51)**	(31)
Total current liabilities		**(2,240)**	(2,879)
Non-current liabilities			
Borrowings	18	**(5,532)**	(3,832)
Derivative financial liabilities	13	**(83)**	(87)
Other non-current liabilities	20	**(1,043)**	(1,012)
Deferred tax liabilities	21	**(1,629)**	(1,626)
Provisions	22	**(65)**	(75)
Total non-current liabilities		**(8,352)**	(6,632)
Total liabilities	1(d)	**(10,592)**	(9,511)
Net assets		**5,980**	5,967
Equity			
Called up share capital	23	**45**	45
Share premium account	24	**204**	204
Retained earnings	24	**4,434**	4,435
Cash flow hedge reserve	24	**(35)**	(49)
Other reserves	24	**1,332**	1,332
Total parent company shareholders' equity and total equity		**5,980**	5,967

These financial statements, comprising the consolidated income statement, consolidated balance sheet, consolidated statement of recognised income and expense, consolidated cash flow statement, accounting policies, adoption of new accounting standards and related notes 1 to 33 were approved by the Board of Directors on 5 June 2008 and were signed on its behalf by:

Mark Fairbairn Director

Adam Wiltshire Director

Consolidated statement of recognised income and expense

for the years ended 31 March

		2008 £m	2007 £m
Net gains taken to equity in respect of cash flow hedges		**14**	5
Transferred to profit or loss on cash flow hedges		**1**	12
Tax on items taken directly to or transferred from equity	7	**(1)**	(6)
Net income recognised directly in equity		**14**	11
Profit for the year		**496**	288
Total recognised income and expense for the year		**510**	299
Attributable to:			
Equity shareholders of the parent		**509**	298
Minority interests		**1**	1
		510	299

Consolidated cash flow statement

for the years ended 31 March

	Notes	2008 £m	2007 £m
Cash flows from operating activities			
Total operating profit		**971**	778
Adjustments for:			
Exceptional items		**23**	14
Depreciation and amortisation		**431**	401
Profit on disposal of property, plant and equipment		**-**	(8)
Share based payment charge		**5**	10
Changes in working capital		**138**	244
Changes in provisions		**10**	(5)
Cash flows relating to exceptional items		**(23)**	(27)
Cash flows generated from continuing operations		**1,555**	1,407
Tax (paid)/received - continuing operations		**(228)**	10
Net cash inflow from operating activities		**1,327**	1,417
Cash flows from investing activities			
Purchases of intangible assets		**(29)**	(20)
Purchases of property, plant and equipment		**(1,451)**	(1,152)
Disposals of property, plant and equipment		**10**	9
Purchases of financial investments		**(136)**	(338)
Cash flows used in continuing operations - investing activities		**(1,606)**	(1,501)
Cash flows (used in)/from discontinued operations - investing activities		**(1)**	28
Net cash flow used in investing activities		**(1,607)**	(1,473)
Cash flows from financing activities			
Proceeds from loans received		**2,120**	3,061
Repayment of loans		**(251)**	(870)
Net movements in short-term borrowings and derivatives		**(1,017)**	(13)
Interest received		**14**	10
Interest paid		**(255)**	(305)
Exceptional finance costs on the repayment of debt		**-**	(32)
Dividends paid to shareholders		**(500)**	(1,850)
Net cash flow from financing activities		**111**	1
Net decrease in cash and cash equivalents		**(169)**	(55)
Cash and cash equivalents at the start of the year (i)		**168**	223
Net cash and cash equivalents at the end of the year (i)	17	**(1)**	168

(i) Net of bank overdraft of £6m (2007: £6m, 2006: £nil).

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

1. Segmental analysis

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

Gas Transmission	The gas transmission network in the UK and the associated UK liquefied natural gas (LNG) storage activities
Gas Distribution	Four of the eight regional networks of Great Britain's gas distribution system
Gas Metering	Regulated gas metering activities in the UK

Other activities relate to our xoserve business which provides transportation transaction services on behalf of all the major gas network transportation companies, including ourselves, together with corporate activities.

Our segments are unchanged from those reported in the financial statements for the year ended 31 March 2007, except that transportation transaction services previously reported as part of the Gas Distribution segment are now included within other activities. Prior year comparatives have been restated to conform with the current classification. All of the Company's sales and operations take place within the UK and therefore there is no secondary reporting format by geographical area.

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

a) Revenue

	Total sales 2008 £m	**Sales between businesses 2008 £m**	**Sales to third parties 2008 £m**	Total sales 2007 Restated £m	Sales between businesses 2007 Restated £m	Sales to third parties 2007 Restated £m
Business segments - continuing operations						
Gas Transmission	**770**	**14**	**756**	736	7	729
Gas Distribution	**1,383**	**61**	**1,322**	1,174	61	1,113
Gas Metering	**349**	**2**	**347**	346	3	343
Other activities	**38**	**23**	**15**	35	21	14
	2,540	**100**	**2,440**	2,291	92	2,199

The table above represents revenue from continuing operations only, as disclosed in the consolidated income statement. There was no revenue from discontinued operations.

b) Operating profit

	Before exceptional items		After exceptional items	
	2008 £m	2007 Restated £m	**2008 £m**	2007 Restated £m
Business segments - continuing operations				
Gas Transmission	**318**	312	**315**	307
Gas Distribution	**595**	406	**575**	397
Gas Metering	**101**	107	**101**	107
Other activities	**(20)**	(33)	**(20)**	(33)
	994	792	**971**	778

The table above represents operating profit from continuing operations only, as disclosed in the consolidated income statement. Discontinued operations had no operating results.

1. Segmental analysis continued

c) Capital expenditure and depreciation

	Capital expenditure		Depreciation and amortisation	
	2008	2007 Restated	**2008**	2007 Restated
	£m	£m	**£m**	£m
Business segments - continuing operations				
Gas Transmission	**800**	628	**122**	99
Gas Distribution	**514**	487	**181**	170
Gas Metering	**73**	82	**127**	132
Other activities	**6**	3	**1**	-
	1,393	1,200	**431**	401

Capital expenditure comprises additions to property, plant and equipment and intangible assets amounting to £1,364m (2007:£1,180m) and £29m (2007: £20m) respectively. There was no capital expenditure in respect of discontinued operations.

Depreciation and amortisation includes depreciation of property, plant and equipment and amortisation of intangible assets amounting to £418m (2007: £391m) and £13m (2007: £10m) respectively. There was no depreciation and amortisation in respect of discontinued operations.

d) Total assets and total liabilities

	Total assets		Total liabilities	
	2008	2007 Restated	**2008**	2007 Restated
	£m	£m	**£m**	£m
Business segments - continuing operations				
Gas Transmission	**3,569**	2,893	**(357)**	(358)
Gas Distribution	**5,758**	5,400	**(1,222)**	(1,184)
Gas Metering	**745**	813	**(144)**	(139)
Other activities	**37**	29	**(44)**	(54)
	10,109	9,135	**(1,767)**	(1,735)
Unallocated	**6,463**	6,343	**(8,825)**	(7,776)
	16,572	15,478	**(10,592)**	(9,511)

The analysis of total assets and total liabilities excludes inter-business balances. Unallocated total assets include amounts owed by fellow subsidiaries, cash and cash equivalents, taxation, financial investments and derivative assets. Unallocated total liabilities include amounts owed to fellow subsidiaries, bank overdrafts, borrowings and derivative financial liabilities, taxation and interest.

2. Other operating income

Other operating income includes income on disposal of properties as a result of property management activities and emission allowances.

3. Operating costs

	Before exceptional items		Exceptional items		Total	
	2008	2007	**2008**	2007	**2008**	2007
	£m	£m	**£m**	£m	**£m**	£m
Depreciation of property, plant and equipment	**418**	391	**-**	-	**418**	391
Amortisation of intangible assets	**13**	10	**-**	-	**13**	10
Payroll costs	**254**	257	**17**	10	**271**	267
Other operating charges:						
Purchases of gas	**110**	113	**-**	-	**110**	113
Rates	**227**	211	**-**	-	**227**	211
Other	**432**	425	**6**	4	**438**	429
	1,454	1,407	**23**	14	**1,477**	1,421
Operating costs include:						
Consumption of inventories					**5**	5
Research expenditure					**2**	1
Operating lease rentals:						
Plant and machinery					**5**	6
Other					**11**	12

(a) Payroll costs

	2008	2007
	£m	£m
Wages and salaries	**240**	234
Social security costs	**22**	22
Other pension costs	**66**	64
Share-based payments	**6**	5
Severance costs (excluding pension costs)	**9**	6
	343	331
Less: payroll costs capitalised	**(72)**	(64)
	271	267

Payroll costs above represent continuing operations only.

(b) Number of employees, including Directors

	31 March 2008 Number	**Average 2008 Number**	Average 2007 Number
UK			
Continuing operations	6,540	6,410	6,617

The vast majority of employees are either directly or indirectly employed in the transmission and distribution of gas.

(c) Key management compensation

	2008	2007
	£m	£m
Salaries and short-term employee benefits	**2**	3
Post-employment benefits	**1**	2
Share-based payments	**1**	1
	4	6

Key management comprises the Board of Directors of the Company together with those Executive Directors of National Grid plc who have managerial responsibility for any of the businesses of National Grid Gas and who are not also Directors of the Company.

3. Operating costs continued

(d) Directors' emoluments

The aggregate amount of emoluments paid to Directors in respect of qualifying services for 2008 was £1,530,063 (2007: £1,638,436). There were no payments in respect of compensation for loss of office in either year. Directors' emoluments include amounts in respect of accrued bonus which had not yet been approved at the date of these accounts.

Five Directors exercised share options during 2008 (2007: two)

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

As at 31 March 2008, retirement benefits were accruing to six Directors under a defined benefit scheme (2007: six - defined benefit schemes).

The aggregate emoluments for the highest paid Director were £464,286 for 2008 (2007: £469,743); and total accrued annual pension at 31 March 2008 for the highest paid Director was £73,796 (2007: £64,960).

(e) Auditors' remuneration

	2008 **£m**	2007 £m
Audit services		
Audit of parent company and consolidated financial statements	**0.9**	0.4
Other services		
Other services supplied pursuant to legislation	**0.4**	0.4

Other services supplied pursuant to legislation represents fees payable for services in relation to engagements which are required to be carried out by the auditor. In particular, this includes fees for audit reports on regulatory returns and fees for reports under section 404 of the US Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley).

4. Exceptional items and remeasurements

	2008 £m	2007 £m
Exceptional items - restructuring costs (i)	**(23)**	(14)
Total exceptional items included within operating profit	**(23)**	(14)
Exceptional items - debt restructuring costs (ii)	**-**	(32)
Remeasurements - gains on derivative financial instruments (iii)	**24**	4
Total exceptional items and remeasurements included within finance costs	**24**	(28)
Total exceptional items and remeasurements before taxation	**1**	(42)
Exceptional tax item - deferred tax credit arising from reduction in UK tax rate (iv)	**117**	-
Tax on exceptional items - restructuring costs (i)	**6**	4
Tax on exceptional items - debt restructuring (ii)	**-**	10
Tax on remeasurements - derivative financial instruments (iii)	**(6)**	(7)
Tax on exceptional items and remeasurements	**117**	7
Total exceptional items and remeasurements after taxation	**118**	(35)
Total exceptional items after taxation	**100**	**(32)**
Total derivative financial instrument remeasurements after taxation	**18**	**(3)**
Total exceptional items and remeasurements after taxation	**118**	**(35)**

(i) Restructuring costs relate to planned cost reduction programmes. For the year ended 31 March 2008, these included pension curtailment costs of £10m arising as a result of redundancies (2007: £5m).

(ii) Debt restructuring costs for the year ended 31 March 2007 represent debt redemption costs relating to the restructuring of our debt portfolio.

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

(iv) The exceptional tax credit in the period arose from a reduction in the UK corporation tax rate from 30% to 28% included in the Finance Act 2007. This resulted in a reduction in deferred tax liabilities.

5. Pensions

Substantially all of National Grid Gas's employees are members of the defined benefit section of the National Grid UK Pension Scheme. There is no contractual arrangement or stated policy for charging the net defined benefit cost of the scheme to National Grid Gas. Accordingly, the Company accounts for the scheme as if it were a defined contribution scheme. For further details regarding the nature and terms of the scheme and the actuarial assumptions used to value the associated assets and pension obligations, refer to note 28.

The following disclosures relate to the scheme as a whole and include amounts not recognised in these financial statements, but which are recognised in the consolidated financial statements of National Grid plc.

	2008 £m	2007 £m
Amounts recognised in the consolidated balance sheet of National Grid plc		
Present value of fund obligations	**(11,814)**	(12,814)
Fair value of plan assets	**12,660**	12,865
	846	51
Present value of unfunded obligations	**(17)**	(14)
Asset in the balance sheet	**829**	37

	2008 £m	2007 £m
Changes in the present value of the defined benefit obligation		
Opening defined benefit obligation (including unfunded obligations)	**12,828**	13,267
Current service cost	**60**	64
Interest cost	**677**	636
Actuarial gains	**(1,134)**	(564)
Curtailment gains on redundancies	**(1)**	(9)
Curtailment gain on sale of business	**(12)**	-
Special termination benefits	**4**	19
Curtailment cost - augmentations	**11**	2
Employee contributions	**9**	7
Benefits paid (including unfunded obligations)	**(611)**	(594)
Closing defined benefit obligation (including unfunded obligations)	**11,831**	12,828

	2008 £m	2007 £m
Changes in the fair value of plan assets		
Opening fair value of plan assets	**12,865**	12,739
Expected return on plan assets	**760**	643
Actuarial losses	**(550)**	(9)
Employer contributions	**200**	93
Employee contributions	**9**	7
Benefits paid	**(611)**	(593)
Expenses paid	**(13)**	(15)
Closing fair value of plan assets	**12,660**	12,865
Expected contributions to defined benefit plans in the following year	**311**	163

6. Finance income and costs

	2008 £m	2007 £m
Interest income on financial instruments (i)	**16**	10
Interest income and similar income	**16**	10
Interest expense on financial liabilities held at amortised cost:		
Interest on bank loans and overdrafts	**(33)**	(11)
Interest on other borrowings	**(343)**	(253)
Exceptional debt redemption costs	**-**	(32)
Interest on derivatives	**(16)**	(3)
Other interest	**(9)**	(9)
Unwinding of discount on provisions	**(1)**	(1)
Less: interest capitalised (ii)	**45**	24
Interest expense	**(357)**	(285)
Net gains on derivative financial instruments included in remeasurements:		
Ineffectiveness on derivatives designated as fair value hedges (iii)	**6**	8
Ineffectiveness on derivatives designated as cash flow hedges	**3**	2
On derivatives not designated as hedges or ineligible for hedge accounting	**15**	(6)
Net gains on derivative financial instruments included in remeasurements (iv)	**24**	4
Interest expense and other finance costs	**(333)**	(281)
Net finance costs	**(317)**	(271)
Comprising:		
Interest income and similar income	**16**	10
Interest expense and other finance costs		
Before exceptional items and remeasurements	**(357)**	(253)
Exceptional items and remeasurements	**24**	(28)
	(317)	(271)

(i) Interest income on financial instruments comprises interest income from bank deposits and other financial assets.

(ii) Interest on funding attributable to assets in the course of construction was capitalised during the year at a rate of 6.4% (2007: 5.9%).

(iii) Derivative net gains on fair value hedges comprise a net gain on the hedging instruments of £46m (2007: net loss of £31m) less a net loss of £40m from the fair value adjustments to the carrying value of debt (2007: net gain of £39m).

(iv) Gains on derivative financial instruments include a net foreign exchange loss on financing activities of £80m (2007:£87m gain). This figure excludes derivative net foreign exchange gains and losses, which have been disclosed at fair value.

7. Taxation

Taxation on items charged/(credited) to the income statement

The tax charge for the year can be analysed as follows:	Before exceptional items		Exceptional items		Total	
	2008 £m	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m
United Kingdom						
Corporation tax at 30% (2007: 30%)	**74**	80	**6**	(18)	**80**	62
Corporation tax adjustment in respect of prior years	**89**	65	**-**	-	**89**	65
	163	145	**6**	(18)	**169**	127
Deferred tax	**94**	93	**-**	-	**94**	93
Deferred tax credit arising from reduction in UK tax rates	**-**	-	**(117)**	-	**(117)**	-
Deferred tax adjustment in respect of prior years	**21**	-	**-**	5	**21**	5
	115	93	**(117)**	5	**(2)**	98
Overseas						
Corporate tax	**-**	**-**	**(6)**	6	**(6)**	6
Corporate tax adjustment in respect of prior years	**-**	1	**-**	**-**	**-**	1
	-	1	**(6)**	6	**(6)**	7
Total tax charge	**278**	239	**(117)**	(7)	**161**	232

Taxation on items charged/(credited) to equity

	2008 £m	2007 £m
Deferred tax charge on revaluation of cash flow hedges	**1**	6
Tax charge recognised in consolidated statement of recognised income and expense	**1**	6
Deferred tax charge/(credit) on share-based payments recognised directly in equity	**5**	(2)
Corporate tax credit on share-based payments recognised directly in equity	**(4)**	(1)
	2	3

The tax charge for the year after exceptional items and remeasurements is lower (2007: higher) than the standard rate of corporation tax in the UK (30%). The differences are explained below:

	Before exceptional items and remeasure-ments 2008 £m	**After exceptional items and remeasure-ments 2008 £m**	Before exceptional items and remeasure-ments 2007 £m	After exceptional items and remeasure-ments 2007 £m
Profit before taxation				
Before exceptional items and remeasurements	**653**	**653**	549	549
Exceptional items and remeasurements	**-**	**1**	-	(42)
Profit before taxation from continuing operations	**653**	**654**	549	507
Profit on continuing operations multiplied by the rate of corporation tax in the UK of 30% (2007: 30%)	**196**	**196**	165	152
Effects of:				
Adjustments in respect of previous years	**110**	**110**	66	71
Expenses not deductible for tax purposes	**6**	**7**	3	3
Non-taxable income	**(4)**	**(4)**	(3)	(4)
Adjustment in respect of foreign tax rates	**-**	**(1)**	-	1
Impact of employee share schemes	**1**	**1**	6	6
Remeasurement of deferred tax - change in UK tax rate	**-**	**(117)**	-	-
Other	**(31)**	**(31)**	2	3
Total taxation from continuing operations	**278**	**161**	239	232
	%	**%**	%	%
At the effective income tax rate	**42.6**	**24.6**	43.5	45.8

7. Taxation continued

Factors that may affect future tax charges

During the year, as a result of the change in the UK corporation tax rate from 30% to 28% that will be effective from 1 April 2008, the deferred tax expected to reverse has been measured using the 28% tax rate.

A number of changes to the UK corporation tax system were announced in the March 2008 Budget Statement and are expected to be enacted in the 2008 Finance Act. These include changes to the industrial buildings allowance regime. The changes have not been substantively enacted as at the balance sheet date and are therefore not included in these financial statements. However, changes to the industrial buildings allowance regime are expected to have a £22m tax charge impact.

8. Discontinued operations

Comprises amounts in respect of the four regional gas distribution networks that were disposed of in June 2005.

	2008 £m	2007 £m
Gain on disposal of discontinued operations before tax	3	10
Taxation	-	3
Gain on disposal of discontinued operations	3	13

9. Dividends

The following table shows the dividends paid to equity shareholders:

	2008 pence (per ordinary share)	**2008 £m**	2007 pence (per ordinary share)	2007 £m
Ordinary dividends				
First interim dividend for the year ended 31 March 2008	**7.61**	**300**	**-**	**-**
Second interim dividend for the year ended 31 March 2008	**5.07**	**200**	-	-
Interim dividend for the year ended 31 March 2007	**-**	**-**	8.87	350
Final dividend for the year ended 31 March 2006	-	-	38.03	1,500
	12.68	**500**	46.90	1,850

10. Intangible assets

	Software £m
Non-current	
Cost at 1 April 2006	76
Additions	20
Cost at 31 March 2007	96
Additions	29
Cost at 31 March 2008	125
Amortisation at 1 April 2006	(42)
Amortisation charge for the year	(10)
Amortisation at 31 March 2007	(52)
Amortisation charge for the year	(13)
Amortisation at 31 March 2008	(65)
Net book value at 31 March 2008	**60**
Net book value at 31 March 2007	44

Current other intangible assets are presented together with inventories in note 14 and consist of emissions allowances of £nil (2007:£2m)

11. Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Assets in the course of construction £m	Motor vehicles and office equipment £m	Total £m
Cost at 1 April 2006	69	11,451	283	547	12,350
Additions	8	590	544	38	1,180
Disposals	(1)	(11)	-	(15)	(27)
Reclassifications	3	36	(59)	20	-
Cost at 31 March 2007	79	12,066	768	590	13,503
Additions	13	552	789	10	1,364
Disposals	(2)	(19)	-	(12)	(33)
Reclassifications	2	964	(1,007)	41	-
Cost at 31 March 2008	92	13,563	550	629	14,834
Depreciation at 1 April 2006	(19)	(3,899)	-	(403)	(4,321)
Depreciation charge for the year	(5)	(337)	-	(49)	(391)
Disposals	-	11	-	15	26
Depreciation at 31 March 2007	(24)	(4,225)	-	(437)	(4,686)
Depreciation charge for the year	(5)	(369)	-	(44)	(418)
Disposals	1	13	-	9	23
Depreciation at 31 March 2008	(28)	(4,581)	-	(472)	(5,081)
Net book value at 31 March 2008	**64**	**8,982**	**550**	**157**	**9,753**
Net book value at 31 March 2007	55	7,841	768	153	8,817

The net book value of land and buildings comprised:

	2008 £m	2007 £m
Freehold	**41**	44
Short leasehold (under 50 years)	**23**	11
	64	55

The cost of property, plant and equipment at 31 March 2008 included £96m (2007: £51m) relating to interest capitalised.

Included within trade and other payables and other non-current liabilities at 31 March 2008 are contributions to the cost of property, plant and equipment amounting to £28m (2007: £26m) and £985m (2007: £955m) respectively.

12. Other non-current assets

	2008 £m	2007 £m
Loans and receivables		
Amounts owed by parent	**5,611**	5,611
Other receivables	**-**	3
	5,611	5,614

The amount owed by the parent is non-contractual and accordingly its fair value equals its book value. The fair value of other non-current receivables approximates to their book value.

13. Derivative financial instruments

For further information and a detailed description of our derivative financial instruments and hedge type designations, refer to note 29. The fair value by designated hedge type can be analysed as follows:

	2008			2007		
	Asset £m	**Liability £m**	**Total £m**	Asset £m	Liability £m	Total £m
Fair value hedges						
Interest rate swaps	**8**	**(3)**	**5**	2	(12)	(10)
Cross-currency interest rate swaps	**98**	**(38)**	**60**	46	(65)	(19)
	106	**(41)**	**65**	48	(77)	(29)
Cash flow hedges						
Interest rate swaps	**29**	**(36)**	**(7)**	3	(3)	-
Cross-currency interest rate swaps	**67**	**(8)**	**59**	26	(7)	19
Foreign exchange forward contracts	**14**	**(5)**	**9**	-	-	-
	110	**(49)**	**61**	29	(10)	19
Derivatives not in a formal hedge relationship						
Interest rate swaps	**9**	**(20)**	**(11)**	9	(11)	(2)
Cross-currency interest rate swaps	**4**	**-**	**4**	-	(3)	(3)
	13	**(20)**	**(7)**	9	(14)	(5)
Total	**229**	**(110)**	**119**	86	(101)	(15)

The maturity of derivative financial instruments is as follows:

	2008			2007		
	Assets £m	**Liabilities £m**	**Total £m**	Assets £m	Liabilities £m	Total £m
In one year or less	**90**	**(27)**	**63**	10	(14)	(4)
Current	**90**	**(27)**	**63**	10	(14)	(4)
In more than one year, but not more than two years	**40**	**(1)**	**39**	23	(4)	19
In more than two years, but not more than three years	**-**	**-**	**-**	12	(7)	5
In more than three years, but not more than four years	**-**	**-**	**-**	-	-	-
In more than four years, but not more than five years	**-**	**(5)**	**(5)**	-	-	-
In more than five years	**99**	**(77)**	**22**	41	(76)	(35)
Non-current	**139**	**(83)**	**56**	76	(87)	(11)
	229	**(110)**	**119**	86	(101)	(15)

For each class of derivative, our exposure, based on the sterling equivalent notional value of the pay leg is as follows:

	2008 £m	2007 £m
Interest rate swaps	**(2,800)**	(2,463)
Cross-currency interest rate swaps	**(1,096)**	(1,637)
Foreign exchange forward contracts	**(176)**	(30)
	(4,072)	(4,130)

14. Inventories and other intangible assets

	2008 £m	2007 £m
Raw materials and consumables	**31**	28
Other intangible assets	-	2
	31	30

Other intangible assets consists of emissions allowances

15. Trade and other receivables

	2008 £m	2007 £m
Trade receivables	**40**	47
Amounts owed by fellow subsidiaries	**99**	91
Other receivables	**43**	33
Prepayments and accrued income	**183**	162
	365	333

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

Provision for impairment of receivables

	£m
At 1 April 2006	3
Release of provision	(1)
Uncollectable amounts written off net of recoveries	1
At 31 March 2007	3
Release of provision	(1)
Uncollectable amounts written off net of recoveries	-
At 31 March 2008	**2**

As at 31 March 2008, trade receivables of £2m (2007: £5m) were past due but not impaired. The ageing analysis of these trade receivables is as follows:

	2008 £m	2007 £m
Up to 3 months past due	**1**	2
3 to 6 months past due	**-**	2
Over 6 months past due	**1**	1
	2	5

For further information about our wholesale credit risk refer to note 30.

16. Financial investments

	2008 £m	2007 £m
Current		
Available-for-sale investments	**490**	300
Loans and receivables - amounts due from fellow subsidiaries	**19**	75
Other loans and receivables	**9**	5
	518	380

Financial investments comprise the following:

	2008 £m	2007 £m
Investments in short-term UK money funds	**490**	300
Loans due from fellow subsidiaries	**19**	75
Restricted cash balances	**9**	5
	518	380

Available-for-sale investments are recorded at their fair value. The fair value of loans and receivables approximates to their book value.

The maximum exposure to credit risk at the reporting date is the fair value of the financial instruments - for further information on our treasury related credit risk refer to note 30. None of the financial investments are past due or impaired.

Restricted cash balances represent cash posted by the Company and its subsidiaries under collateral agreements.

17. Cash and cash equivalents

	2008 £m	2007 £m
Cash at bank	**1**	1
Short-term deposits	**4**	173
Cash and cash equivalents excluding bank overdrafts	**5**	174
Bank overdrafts	**(6)**	(6)
Net cash and cash equivalents	**(1)**	168

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

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

18. Borrowings

The following table analyses borrowings, including bank overdrafts:

	2008 £m	2007 £m
Current		
Bank loans	**41**	25
Bonds	**688**	342
Other loans	**2**	1
Borrowings from fellow subsidiaries	**547**	1,517
Bank overdrafts	**6**	6
	1,284	1,891
Non-current		
Bank loans	**584**	380
Bonds	**4,836**	3,351
Other loans	**112**	101
	5,532	3,832
Total borrowings	**6,816**	5,723

Total borrowings are repayable as follows:	2008 £m	2007 £m
In one year or less	**1,284**	1,891
In more than one year, but not more than two years	**710**	459
In more than two years, but not more than three years	**-**	494
In more than three years, but not more than four years	**-**	-
In more than four years, but not more than five years	**215**	-
In more than five years other than by instalments	**4,607**	2,879
	6,816	5,723

The fair value of borrowings at 31 March 2008 was £6,432m (2007: £5,680m). Market values, where available, have been used to determine fair values. Where market values are not available, fair values have been calculated by discounting cash flows at prevailing interest rates.

The notional amount outstanding of the debt portfolio as at 31 March 2008 was £7,076m (2007: £6,097m).
Collateral is placed with or received from any counterparty where we have entered into a credit support annex to the ISDA Master Agreement once the current mark-to-market valuation of the trades between the parties exceeds an agreed threshold. Included in current bank loans is £39m (2007: £25m) in respect of cash received under collateral agreements. Cash placed under collateral agreements is shown in note 16.

As at 31 March 2008, the Company had committed credit facilities of £810m (2007: £840m) of which £810m was undrawn (2007: £840m undrawn). These undrawn facilties expire in more than two years.

All of the unused facilities at 31 March 2008 and at 31 March 2007 were held as back-up to commercial paper and similar borrowings.

19. Trade and other payables

	2008 £m	2007 £m
Trade payables	**444**	425
Amounts owed to fellow subsidiaries	**243**	287
Social security and other taxes	**85**	96
Other payables	**25**	24
Deferred income	**54**	71
	851	903

Due to their short maturities, the fair value of trade and other payables (excluding deferred income) approximates to their book value.

20. Other non-current liabilities

	2008 £m	2007 £m
Trade payables	**-**	5
Other payables	**3**	3
Deferred income	**1,040**	1,004
	1,043	1,012

The fair value of trade and other payables approximates to their book value.

21. Deferred tax assets and liabilities

The following are the major deferred tax assets and liabilities recognised and the movements thereon, during the current and prior years :

	Accelerated tax depreciation £m	Employee share options £m	Financial instruments £m	Other net temporary differences £m	Total £m
Deferred tax assets at 31 March 2006	-	(15)	-	(22)	(37)
Deferred tax liabilities at 31 March 2006	1,516	-	11	53	1,580
At 1 April 2006	1,516	(15)	11	31	1,543
Charged to income statement	83	7	-	8	98
(Credited)/charged to equity	-	(2)	6	-	4
Disposal of subsidiaries	-	-	-	(19)	(19)
At 31 March 2007	1,599	(10)	17	20	1,626
Deferred tax assets at 31 March 2007	-	(10)	-	(14)	(24)
Deferred tax liabilities at 31 March 2007	1,599	-	17	34	1,650
At 1 April 2007	1,599	(10)	17	20	1,626
Charged/(credited) to income statement	3	-	(4)	(2)	(3)
Charged to equity	-	5	1	-	6
At 31 March 2008	**1,602**	**(5)**	**14**	**18**	**1,629**
Deferred tax assets at 31 March 2008	-	(5)	-	(14)	(19)
Deferred tax liabilities at 31 March 2008	1,602	-	14	32	1,648
At 31 March 2008	1,602	(5)	14	18	1,629

Deferred tax assets are all offset against deferred tax liabilities.

At the balance sheet date there were no material current deferred tax assets or liabilities (2007: £nil).

Deferred tax assets in respect of capital losses of £18m (2007: £nil) have not been recognised as their future recovery is uncertain or not currently anticipated. The capital losses are available to carry forward indefinitely. The capital losses can be offset against specific types of future capital gains.

22. Provisions

	Environmental £m	Emissions £m	Restructuring £m	Other £m	Total provisions £m
At 1 April 2006	44	23	33	28	128
Additions	-	13	14	17	44
Release of unused amounts	-	(23)	(2)	-	(25)
Unwinding of discount	1	-	-	-	1
Utilised	(1)	(12)	(25)	(4)	(42)
At 31 March 2007	44	1	20	41	106
Additions	-	5	23	12	40
Release of unused amounts	-	(1)	-	(5)	(6)
Unwinding of discount	1	-	-	-	1
Utilised	(1)	-	(22)	(2)	(25)
At 31 March 2008	**44**	**5**	**21**	**46**	**116**

Provisions have been analysed between current and non-current as follows:

	2008 £m	2007 £m
Current	**51**	31
Non-current	**65**	75
	116	106

Environmental provision

The environmental provision represents the net present value of the estimated statutory decontamination costs of old gas manufacturing sites owned by National Grid Gas (discounted using a nominal rate of 5.0%). The anticipated timing of the cash flows for statutory decontamination cannot be predicted with certainty, but they are expected to be incurred over the next 50 years.

There are a number of uncertainties that affect the calculation of the provision for gas site decontamination, including the impact of regulation, the accuracy of the site surveys, unexpected contaminants, transportation costs, the impact of alternative technologies and changes in the discount rate. We have made our best estimate of the financial effect of these uncertainties in the calculation of the provision, but future material changes in any of the assumptions could materially impact on the calculation of the provision and hence the income statement.
The undiscounted amount of the provision at 31 March 2008 relating to gas site decontamination was £69m (2007: £70m), being the best undiscounted estimate of the liability having regard to the uncertainties referred to above.

Emissions provision

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

Restructuring provision

At 31 March 2008, £6m of the total restructuring provision (2007: £7m) consisted of provisions for the disposal of surplus leasehold interests and rates payable on surplus properties. The expected payment dates for property restructuring costs remain uncertain. The remainder of the restructuring provision related to business reorganisation costs, largely to be paid within the next financial year.

Other provisions

Other provisions at 31 March 2008 include £17m (2007: £24m) in respect of property transfer costs related to the sales of four UK gas distribution networks and £18m (2007: £17m) in respect of employer liability claims. The payment dates for the property transfer costs are uncertain but should largely be over the next three years. In accordance with insurance industry practice, the estimates for employer liability claims are based on experience from previous years and, therefore, there is no identifiable payment date associated with these items.

23. Share capital

	Number of shares 2008 millions	Number of shares 2007 millions	**2008 £m**	2007 £m
At 31 March 2007 and 2008 - ordinary shares of $1^{2}/_{15}$p each				
Allotted, called up and fully paid	**3,944**	3,944	**45**	45
Authorised	**6,052**	6,052	**69**	69

24. Reconciliation of movements in total equity

	Called-up share capital £m	Share premium account £m	Cash flow hedge reserve £m	Other reserves £m	Retained earnings £m	Total shareholders' equity £m	Minority interest £m	Total equity £m
At 1 April 2006	45	204	(60)	1,332	5,985	7,506	-	7,506
Total recognised income and expense for the year	-	-	11	-	287	298	1	299
Equity dividends	-	-	-	-	(1,850)	(1,850)	-	(1,850)
Other movements in minority interests	-	-	-	-	-	-	(1)	(1)
Share-based payments	-	-	-	-	10	10	-	10
Tax on share-based payments	-	-	-	-	3	3	-	3
At 31 March 2007	45	204	(49)	1,332	4,435	5,967	-	5,967
Total recognised income and expense for the year	-	-	14	-	495	509	1	510
Equity dividends	-	-	-	-	(500)	(500)	-	(500)
Other movements in minority interests	-	-	-	-	-	-	(1)	(1)
Share-based payments	-	-	-	-	5	5	-	5
Tax on share-based payments	-	-	-	-	(1)	(1)	-	(1)
At 31 March 2008	**45**	**204**	**(35)**	**1,332**	**4,434**	**5,980**	**-**	**5,980**

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

Gains and losses recognised in the cash flow hedge reserve on interest rate swap contracts as of 31 March 2008 will be continuously transferred to the income statement until the borrowings are repaid (note 18).

The amount of the cash flow hedge reserve due to be released from reserves to the income statement within the next year is £2m, with the remaining amount due to be released with the same maturity profile as borrowings in note 18.

25. Consolidated cash flow statement

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

	2008 **£m**	2007 £m
Movement in cash and cash equivalents	**(169)**	(55)
Increase in financial investments	**136**	328
Increase in borrowings and derivatives	**(852)**	(2,188)
Net interest paid	**232**	337
Change in net debt resulting from cash flows	**(653)**	(1,578)
Changes in fair value of financial assets and liabilities	**39**	21
Net interest charge	**(376)**	(289)
Movement in net debt (net of related derivative financial instruments) in the year	**(990)**	(1,846)
Net debt at start of year	**(5,184)**	(3,338)
Net debt (net of related derivative financial instruments) at end of year	**(6,174)**	(5,184)

b) Analysis of changes in net debt

	Cash and cash equivalents £m	Bank overdrafts £m	Net cash £m	Financial investments £m	Borrowings £m	Derivatives £m	Total debt £m
At 1 April 2006	223	-	223	42	(3,712)	109	(3,338)
Cash flow	(49)	(6)	(55)	328	(1,710)	(141)	(1,578)
Fair value gains and losses	-	-	-	-	4	17	21
Interest charges	-	-	-	10	(299)	-	(289)
At 31 March 2007	174	(6)	168	380	(5,717)	(15)	(5,184)
Cash flow	(169)	-	(169)	122	(612)	6	(653)
Fair value gains and losses	-	-	-	-	(105)	144	39
Interest charges	-	-	-	16	(376)	(16)	(376)
At 31 March 2008	**5**	**(6)**	**(1)**	**518**	**(6,810)**	**119**	**(6,174)**

Notes to the consolidated financial statements - supplementary information

26. Commitments and contingencies

a) Future capital expenditure

	2008 £m	2007 £m
Contracted for but not provided	**461**	753

b) Lease commitments

Total commitments under non-cancellable operating leases were as follows:

	2008 £m	2007 £m
Amounts due:		
In one year or less	**11**	10
In more than one year, but not more than two years	**10**	9
In more than two years, but not more than three years	**8**	7
In more than three years, but not more than four years	**8**	5
In more than four years, but not more than five years	**7**	5
In more than five years	**38**	32
	82	68

The majority of the leases are in respect of properties.

c) Amounts receivable under sublease arrangements

The total of future minimum sublease payments expected to be received under non-cancellable subleases is £3m (2007: £5m).

d) Other commitments, contingencies and guarantees

The value of other commitments, contingencies and guarantees at 31 March 2008 amounted to £84m (2007: £213m), including performance guarantees amounting to £5m (2007: £6m), relating to certain property obligations of a National Grid group undertaking, and BG Group related commitments and contingencies amounting to £nil (2007: £7m).

e) Parent company loan guarantees on behalf of subsidiaries

The Company has guaranteed the repayment of principal sums, any associated premium and interest on specific loans due from its financial subsidiaries to third parties. At 31 March 2008, the sterling equivalent amounted to £1,159m (2007: £1,108m).

f) Litigation and claims

On 28 February 2008, the Gas and Electricity Markets Authority imposed a £41.6m fine on National Grid Gas plc for infringement of the Competition Act 1998 in relation to a number of metering contracts entered into with gas suppliers in 2004. We believe that the contracts do not infringe competition law, were entered into voluntarily by gas suppliers and Ofgem was consulted throughout the process of contract development and negotiation. Therefore, we have lodged an appeal with the Competition Appeal Tribunal. The fine has been suspended pending the outcome of the appeal and no provision has been made in the accounts.

We remain convinced that National Grid Gas has not breached the Competition Act 1998, that our position will be upheld and the fine reversed on appeal.

27. Related party transactions

The following information is provided in accordance with IAS 24, Related party disclosures, as being material transactions with related parties during the year. These transactions are with fellow subsidiaries of National Grid and a pension plan, in the normal course of business and are summarised below.

	Parent		Other related parties		Total	
	2008	2007	**2008**	2007	**2008**	2007
	£m	£m	**£m**	£m	**£m**	£m
Income:						
Goods and services supplied	**-**	-	**25**	51	**25**	51
Expenditure:						
Services received	**-**	-	**68**	100	**68**	100
Corporate services received	**-**	-	**22**	18	**22**	18
Charges in respect of pensions costs	**-**	-	**(26)**	12	**(26)**	12
Charges in respect of share-based payments		-	**6**	1	**6**	1
Interest paid on borrowings from fellow subsidiaries	**33**	60	**13**	10	**46**	70
	33	60	**83**	141	**116**	201
Outstanding balances at 31 March in respect of income, expenditure and settlement of corporation tax:						
Amounts receivable	**-**	74	**99**	17	**99**	91
Amounts payable	**-**	-	**243**	287	**243**	287
Advances to fellow subsidiaries (due within one year):						
At 1 April	**-**	-	**75**	8	**75**	8
Advances	**19**	-	**-**	67	**19**	67
Repayments	**-**	-	**(75)**		**(75)**	-
At 31 March	**19**	-	**-**	75	**19**	75
Advances to parent (due after more than one year):						
At 1 April and 31 March	**5,611**	5,611	**-**	-	**5,611**	5,611
Borrowings payable to fellow subsidiaries (amounts due within one year):						
At 1 April	**1,314**	2	**203**	11	**1,517**	13
Advances	**-**	3,725	**288**	192	**288**	3,917
Repayments	**(1,128)**	(2,413)	**(130)**	-	**(1,258)**	(2,413)
At 31 March	**186**	1,314	**361**	203	**547**	1,517

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

No amounts have been provided at 31 March 2008 (2007: £nil) and no expense recognised during the year (2007: £nil) in respect of bad or doubtful debts for related party transactions.

Details of guarantees provided in respect of related parties are provided in note 26.

Details of key management compensation are provided in note 3(c).

During the year ended 31 March 2008, bonds with a nominal value of £982m were transferred to the Company from National Grid Gas Holdings plc at their fair value of £1,203m plus accrued interest.

28. Actuarial information on pensions

The National Grid UK Pension Scheme is funded with assets held in a separate trustee administered fund. The scheme is subject to independent actuarial valuation at least every three years, on the basis of which the qualified actuary certifies the rate of employers' contribution which, together with the specified contributions payable by employees and the proceeds from the scheme's assets, are expected to be sufficient to fund the benefits payable under the scheme.The scheme provides final salary defined benefits for employees who joined prior to 31 March 2002 and defined contribution benefits for employees joining from 1 April 2002.

The latest full actuarial valuation was carried out by Watson Wyatt LLP at 31 March 2006. The aggregate market value of the scheme's assets was £12,743m and the value of the assets represented 97% of the actuarial value of benefits due to members, calculated on the basis of pensionable earnings and service at 31 March 2006 on an ongoing basis and allowing for projected increases in pensionable earnings. There was a funding deficit of £371m on the valuation date.

The results of the actuarial valuation carried out at 31 March 2006 showed that, based on long-term financial assumptions, the contribution rate required to meet future benefit accrual was 32% of pensionable earnings (29% employers and 3% employees). The ongoing contribution rate does not include an allowance for administration expenses. These contributions are reviewed annually. From 1 April 2007, the rate used for the recovery of administration costs was 3.7% of salary. Employers are currently, therefore, paying a contribution rate of 32.7%. The contribution rate will be reviewed as part of the actuarial valuation which is currently in progress.

In line with the agreement made after the 2003 valuation, no funding of the deficit identified in the 2006 actuarial valuation will need to be provided to the scheme until the outcome of the actuarial valuation as at 31 March 2007 is known. At this point, National Grid will pay the gross amount of any deficit up to a maximum amount of £520m (£373m net of tax) into the scheme. Until the 31 March 2007 actuarial valuation has been completed, National Grid has arranged for banks to provide the trustees with letters of credit. The main conditions under which these letters of credit could be drawn relate to events which would imperil the interests of the scheme, such as National Grid Gas plc becoming insolvent or National Grid failing to make agreed payments into the scheme.

The actuarial valuation as at 31 March 2007 is currently in progress, but has not yet been completed. In anticipation of the finalisation of the valuation, National Grid Gas made deficit payments to the scheme totalling £114m (£83m net of tax) prior to 31 March 2008 (which were reimbursed by Lattice Group plc) and a further £305m (£220m net of tax) was paid to the scheme to 31 May 2008. National Grid and the Trustees are currently in the process of agreeing a recovery plan in respect of the deficit expected to be included in the valuation.

Assets allocations and actuarial assumptions

The major categories of plan assets as a percentage of total plan assets were as follows:

	2008	2007
	%	%
Equities	**33.8**	33.2
Corporate bonds	**26.7**	19.8
Gilts	**29.9**	34.9
Property	**6.8**	8.7
Other	**2.8**	3.4
Total	**100.0**	100.0

The expected long-term rate of return on assets has been set reflecting the price inflation expectation, the expected real return on each major asset class and the long-term asset allocation strategy adopted for the scheme. The expected real returns on specific assets classes reflect historical returns, investment yields on the measurement date and general future return expectations, and have been set after taking advice from the scheme's actuaries. The current target asset allocation for the scheme is 34% equities, 58% bonds and 8% property and other.

	2008	2007
The principal actuarial assumptions used were:	**%**	%
Discount rate (i)	**6.6**	5.4
Expected return on plan assets	**6.1**	5.8
Rate of increase in salaries (ii)	**4.6**	4.2
Rate of increase in pensions in payment and deferred pensions	**3.8**	3.3
Rate of increase in Retail Prices Index	**3.7**	3.2

(i) The discount rate for pension liabilities has been determined by reference to appropriate yields prevailing in the UK debt markets at the balance sheet date.

(ii) A promotional age related scale has been used where appropriate.

28. Actuarial information on pensions continued

The assumed life expectations for a retiree at age 65 are as follows:

	2008 Years	2007 Years
Today:		
Males	20.7	20.0
Females	23.0	22.3
In 20 years:		
Males	23.0	21.2
Females	25.3	23.4

Sensitivities analysed - all other assumptions held constant:

	Change in pension obligations		**Change in annual pension cost**	
	2008 £m	2007 £m	**2008 £m**	2007 £m
0.1% increase (2007:0.1% decrease) in discount rate	**169**	200	**2**	2
0.5% increase in long term rate of increase in salaries	**67**	78	**2**	4
Increase of one year to life expectancies at age 60	**360**	403	**1**	2

29. Supplementary information on derivative financial instruments

Derivatives are financial instruments that derive their value from the price of an underlying item such as interest rates, foreign exchange, credit spreads, or other indices. Derivatives enable their users to alter exposure to market or credit risks. We use derivatives to manage our treasury risks.

Treasury financial instruments

Derivatives are used for hedging purposes in the management of exposure to market risks. This enables the optimisation of the overall cost of accessing debt capital markets, and to mitigate the market risk which would otherwise arise from the maturity and other risk profiles of its assets and liabilities.

Hedging policies using derivative financial instruments are further explained in note 30. Derivatives that are held as hedging instruments are formally designated as hedges as defined in IAS 39. Derivatives may qualify as hedges for accounting purposes if they are fair value hedges or cash flow hedges. These are described as follows:

Fair value hedges

Fair value hedges principally consist of interest rate and cross-currency swaps that are used to protect against changes in the fair value of fixed-rate, long-term financial instruments due to movements in market interest rates. For qualifying fair value hedges, all changes in the fair value of the derivative and changes in the fair value of the item in relation to the risk being hedged are recognised in remeasurements within the income statement. If the hedge relationship is terminated, the fair value adjustment to the hedged item continues to be reported as part of the basis of the item and is amortised to the income statement as a yield adjustment over the remainder of the hedging period.

Cash flow hedges

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

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

The gains and losses on ineffective portions of such derivatives are recognised immediately in remeasurements within the income statement.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement or on the balance sheet. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to remeasurements within the income statement.

Derivatives not in a formal hedge relationship

Our policy is not to use derivatives for trading purposes, however, due to the complex nature of hedge accounting under IAS 39, some derivatives may not qualify for hedge accounting, or are specifically not designated as a hedge where natural offset is more appropriate.

Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in remeasurements within the income statement.

30. Financial risk

Our activities expose us to a variety of financial risks: market risk (including foreign exchange risk; fair value interest rate risk and cash flow interest rate risk), credit risk and liquidity risk. The overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on financial performance. Derivative financial instruments are used to hedge certain risk exposures.

Risk management related to financial activities is carried out by a central treasury department under policies approved by the Board of Directors of National Grid plc. This department identifies, evaluates and hedges financial risks in close co-operation with the operating units. The Board of National Grid plc provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity as discussed further in our treasury policy, described on pages 28 and 29 of the Operating and Financial Review.

(a) Market risk

(i) Foreign exchange risk

National Grid Gas is exposed to foreign exchange risk arising from non-sterling future commercial transactions and non-sterling recognised assets and liabilities.

With respect to near term foreign exchange risk, we use foreign exchange forwards to manage foreign exchange transaction exposure. Our policy is to hedge a minimum percentage of known contracted foreign currency flows in order to mitigate foreign currency movements in the intervening period. Where cash forecasts are less certain, we generally cover a percentage of the foreign currency flows depending on the level of agreed probability for those future cash flows.

During 2008 and 2007, derivative financial instruments were used to manage foreign currency risk as follows:

	2008				
	Sterling £m	**Euro £m**	**US dollar £m**	**Other £m**	**Total £m**
Cash and cash equivalents	**5**	**-**	**-**	**-**	**5**
Financial investments	**518**	**-**	**-**	**-**	**518**
Borrowings*	**(5,584)**	**(336)**	**(504)**	**(392)**	**(6,816)**
Pre-derivative position	**(5,061)**	**(336)**	**(504)**	**(392)**	**(6,293)**
Derivative effect	**(1,103)**	**340**	**490**	**392**	**119**
Net debt position	**(6,164)**	**4**	**(14)**	**-**	**(6,174)**

	2007				
	Sterling £m	Euro £m	US dollar £m	Other £m	Total £m
Cash and cash equivalents	174	-	-	-	174
Financial investments	380	-	-	-	380
Borrowings*	(4,653)	(249)	(486)	(335)	(5,723)
Pre-derivative position	(4,099)	(249)	(486)	(335)	(5,169)
Derivative effect	(1,090)	280	460	335	(15)
Net debt position	(5,189)	31	(26)	-	(5,184)

*Includes bank overdrafts

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

30. Financial risk continued

(a) Market risk continued

(ii) Cash flow and fair value interest rate risk

Interest rate risk arises on our borrowings. Borrowings issued at variable rates expose National Grid Gas to cash flow interest rate risk. Borrowings issued at fixed rates expose National Grid Gas to fair value interest rate risk. Our interest rate risk management policy as further explained on page 28 is to minimise the finance costs (being interest costs and changes in the market value of debt). Some of our borrowings issued are index-linked, that is their cost is linked to changes in the UK Retail Prices Index (RPI). We believe that these borrowings provide a good hedge for revenues and our regulatory asset values that are also RPI-linked.

Interest rate risk arising from our financial investments is primarily variable being mainly composed of short dated money funds.

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

	2008 £m	2007 £m
Fixed interest rate borrowings		
In one year or less	**(631)**	(310)
In more than one year but not more than two years	**(533)**	(420)
In more than two years but not more than three years	**-**	(494)
In more than four years but not more than five years	**(15)**	-
In more than five years	**(1,871)**	(1,109)
	(3,050)	(2,333)
Floating interest rate borrowings (including RPI)	**(3,766)**	(3,390)
Total borrowings	**(6,816)**	(5,723)

During 2008 and 2007, net debt was managed using derivative instruments to hedge interest rate risk as follows:

	2008				
	Fixed rate £m	**Floating rate £m**	**RPI (i) £m**	**Other (ii) £m**	**Total £m**
Cash and cash equivalents	**-**	**5**	**-**	**-**	**5**
Financial investments	**-**	**518**	**-**	**-**	**518**
Borrowings*	**(3,050)**	**(1,012)**	**(2,754)**	**-**	**(6,816)**
Pre-derivative position	**(3,050)**	**(489)**	**(2,754)**	**-**	**(6,293)**
Derivative effect	**1,093**	**(982)**	**-**	**8**	**119**
Net debt position	**(1,957)**	**(1,471)**	**(2,754)**	**8**	**(6,174)**

	2007				
	Fixed rate £m	Floating rate £m	RPI(i) £m	Other (ii) £m	Total £m
Cash and cash equivalents	-	174	-	-	174
Financial investments	-	305	-	75	380
Borrowings*	(2,327)	(1,820)	(1,576)	-	(5,723)
Pre-derivative position	(2,327)	(1,341)	(1,576)	75	(5,169)
Derivative effect	979	(994)	-	-	(15)
Net debt position	(1,348)	(2,335)	(1,576)	75	(5,184)

*Includes bank overdrafts

(i) Represents financial instruments which are linked to the UK Retail Prices Index.

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

30. Financial risk continued

(b) Credit risk

Credit risk is managed on a portfolio basis for the National Grid group as a whole. Credit risk arises from cash and cash equivalents, derivative financial instruments and deposits with banks and financial institutions, as well as credit exposures to wholesale and retail customers, including outstanding receivables and committed transactions.

Treasury related credit risk

Counterparty risk arises from the investment of surplus funds and from the use of derivative instruments. Our limits are managed by the central treasury department of National Grid plc, as explained in our treasury policies on page 28.

As at 31 March 2008 and 2007, we had a number of exposures to individual counterparties. In accordance with our treasury policies and exposure management practices, counterparty credit exposure limits are continually monitored and no individual exposure is considered significant in the ordinary course of treasury management activity. We do not expect any significant losses from non-performance by these counterparties.

The counterparty exposure under derivative financial contracts as shown in note 13 was £229m (2007: £86m); after netting agreements it was £180m (2007: £63m). This exposure is further reduced by collateral received as shown in note 16.

Wholesale and retail credit risk

Our principal commercial exposure is governed by the credit rules within the Uniform Network Code. These lay down the level of credit relative to the regulatory asset value for each credit rating. Sales to retail customers, such as those requiring connections, are usually settled in cash or using major credit cards. Management does not expect any significant losses of receivables that have not been provided for as shown in note 15.

(c) Liquidity analysis

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

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

At 31 March 2008	**Due within 1 year £m**	**Due between 1 and 2 years £m**	**Due between 2 and 3 years £m**	**Due 3 years and beyond £m**	**Total £m**
Non-derivative financial liabilities					
Borrowings	**(1,188)**	**(709)**	**-**	**(5,172)**	**(7,069)**
Interest payments on borrowings (i)	**(230)**	**(191)**	**(171)**	**(3,304)**	**(3,896)**
Other non-interest bearing liabilities	**(712)**	**(3)**	**-**	**-**	**(715)**
Derivative financial liabilities					
Derivative contracts - receipts	**91**	**64**	**20**	**2,414**	**2,589**
Derivative contract - payments	**(45)**	**(24)**	**(24)**	**(3,075)**	**(3,168)**
Total at 31 March 2008	**(2,084)**	**(863)**	**(175)**	**(9,137)**	**(12,259)**

At 31 March 2007	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 3 years £m	Due 3 years and beyond £m	Total £m
Non-derivative financial liabilities					
Borrowings	(1,815)	(466)	(500)	(3,321)	(6,102)
Interest payments on borrowings (i)	(165)	(136)	(110)	(2,119)	(2,530)
Other non-interest bearing liabilities	(736)	(8)	-	-	(744)
Derivative financial liabilities					
Derivative contract - receipts	50	34	10	112	206
Derivative contract - payments	(52)	(27)	(12)	(158)	(249)
Total at 31 March 2007	(2,718)	(603)	(612)	(5,486)	(9,419)

(i) The interest on borrowings is calculated based on borrowings held at 31 March without taking account of future issues. Floating rate interest is estimated using a future interest rate curve as at 31 March.

30. Financial risk continued

(d) Sensitivity analysis

Financial instruments affected by market risk include borrowings, deposits and derivative financial instruments. The following analysis, required by IFRS 7, is intended to illustrate the sensitivity to changes in market variables, being UK interest rates and the UK Retail Prices Index.

The analysis excludes the impact of movements in market variables on the carrying value of provisions.

The sensitivity analysis has been prepared on the basis that the amount of net debt, the ratio of fixed to floating interest rates of the debt and derivatives portfolio, and the proportion of financial instruments in foreign currencies are all constant, and on the basis of the hedge designations in place at 31 March 2008 and 31 March 2007, respectively. As a consequence, this sensitivity analysis relates to the position at these dates and is not representative of the year then ended, as all of these items varied.

The following assumptions were made in calculating the sensitivity analysis:

- the balance sheet sensitivity to interest rates relates only to derivative financial instruments and available-for-sale investments, as debt and other deposits are carried at amortised cost and so their carrying value does not change as interest rates move;
- the sensitivity of accrued interest to movements in interest rates is calculated on net floating rate exposures on debt, deposits and derivative instruments;
- changes in the carrying value of derivatives from movements in interest rates designated as cash flow hedges are assumed to be recorded fully within equity;
- changes in the carrying value of derivative financial instruments not in hedging relationships only affect the income statement;
- all other changes in the carrying value of derivative financial instruments designated as hedges are fully effective with no impact on the income statement;
- debt with a maturity below one year is floating rate for the accrued interest part of the calculation;
- the floating leg of any swap or any floating rate debt is treated as not having any interest rate already set. Therefore, a change in interest rates affects a full twelve-month period for the accrued interest portion of the sensitivity calculations; and
- sensitivity to the Retail Prices Index does not take into account any changes to revenue or operating costs that are affected by the Retail Prices Index or inflation generally.

Using the above assumptions, the following table shows the illustrative effect on the income statement and items that are recognised directly in equity that would result from reasonably possible movements in changes in the UK Retail Prices Index and UK interest rates, after the effects of tax.

	2008		2007	
	Income statement -/+ £m	**Equity -/+ £m**	Income statement -/+ £m	Equity -/+ £m
UK Retail Prices Index +/- 0.50%	**10**	**-**	6	-
UK interest rates +/- 0.50%	**5**	**12**	8	11

The income statement sensitivities impact interest expense and financial instrument remeasurements.

(e) Capital and risk management

The Company's objective when managing capital is to safeguard its ability to continue as a going concern and to remain within regulatory constraints. The principal measure of our balance sheet efficiency is our adjusted gearing ratio. Our adjusted gearing ratio at 31 March 2008 was 44% compared with 40% at 31 March 2007.

31. Share options and reward plans

National Grid operates three principal forms of share option and award plans in which our employees and Directors participate. These are an employee Sharesave scheme, a Performance Share Plan (PSP) and the Deferred Share Plan.

Active share plans

The Sharesave scheme is savings related where, under normal circumstances, share options are exercisable on completion of a three or a five-year Save-As-You-Earn contract. The exercise price of options granted represents 80% of the market price at the time of the invitation.

Under the PSP, awards have been made to Directors and approximately 110 senior employees. Awards made in 2004 have lapsed. For awards made from 2005, the criteria was amended so that 50% is based on National Grid's Total Shareholder Return (TSR) performance when compared to the FTSE 100 and 50% is based on the annualised growth of National Grid's earnings per share. Awards are delivered in National Grid plc shares.

Under the Deferred Share Plan, one half of any bonus earned by Executive Directors of National Grid plc and a predetermined part of any bonus earned by other Directors and senior employees is automatically deferred into National Grid shares. The shares are held in trust for three years before release.

Additional information in respect of active share schemes

	2008 000s	2007 000s
Performance share plan		
Awards of ordinary share equivalents at 1 April	**1,134**	1,149
Awards made	**365**	419
Lapses/forfeits	**(346)**	(422)
Exercises	**(9)**	(12)
Transfers (i)	**(154)**	-
Awards of ordinary share equivalents at 31 March	**990**	1,134
Conditional awards available for release at 31 March	**-**	-
Deferred share plan		
Awards of ordinary share equivalents at 1 April	**45**	-
Awards made	**30**	45
Lapses/forfeits	**-**	-
Exercises	**-**	-
Transfers (i)	**(9)**	-
Awards of ordinary share equivalents at 31 March	**66**	45
Conditional awards available for release at 31 March	**-**	-

(i) Transfers arise from employees moving between National Grid Gas and other companies in the National Grid group.

Non-Active share plans

We also have a number of historical plans under which awards are still outstanding, but no further awards will be granted. These include the Executive Share Option Plan and the Share Matching Plan.

The Executive Share Option Plan applied to senior executives, including Executive Directors of National Grid plc. Options granted were subject to the achievement of performance targets related to National Grid's TSR over a three-year period and those for 2000 are awaiting retest. The share options are generally exercisable between the third and tenth anniversaries of the date of grant if the relevant performance target is achieved.

The Share Matching Plan applied to Executive Directors of National Grid plc and other Directors and senior employees whereby a predetermined part of each participant's bonus entitlement is automatically deferred into National Grid plc shares (known as qualifying shares) and a matching award may be exercised under the Plan after a three-year period, provided the Director or senior employee remains employed by the National Grid group.

Additional information in respect of non-active share schemes

	2008 000s	2007 000s
Share matching plan		
Awards at 1 April	**26**	**38**
Awards exercised	**(6)**	**(12)**
Awards of ordinary share equivalents at 31 March	**20**	**26**
Conditional awards available for release at 31 March	**10**	**-**

31. Share options and reward plans continued

Share Options

Movements in options to subscribe for ordinary shares under National Grid's various option schemes for the two years ended 31 March 2008 is shown below:

	Sharesave scheme options		Executive Plan options		Total options
	Weighted average price £	millions	Weighted average price £	millions	millions
At 31 March 2006	3.68	11.1	4.78	0.2	11.3
Granted	5.58	2.8	-	-	2.8
Lapsed - expired	3.91	(0.3)	-	-	(0.3)
Exercised	3.30	(1.2)	-	-	(1.2)
Transfers (i)	-	-	5.01	(0.1)	(0.1)
At 31 March 2007	4.16	12.4	4.34	0.1	12.5
Granted	6.55	1.7	-	-	1.7
Lapsed - expired	4.44	(0.4)	-	-	(0.4)
Exercised	3.24	(3.4)	4.42	(0.1)	(3.5)
Transfers (i)	-	-	4.56	0.1	0.1
At 31 March 2008	**4.85**	**10.3**	**4.51**	**0.1**	**10.4**

Included within options outstanding at 31 March 2008 and 31 March 2007 were the following options which were exercisable:

At 31 March 2008	**3.81**	**0.2**	**4.34**	**0.1**	**0.3**
At 31 March 2007	3.17	2.9	4.34	0.1	3.0

(i) Transfers arise from employees moving between National Grid Gas and other companies in the National Grid group.

The weighted average remaining contractual life of options in the employee Sharesave scheme at 31 March 2008 was 2 years and 2 months. These options have exercise prices between £3.17 and £6.55.

The weighted average share prices at the exercise dates were as follows:

	2008 £	2007 £
Sharesave scheme options	**7.79**	6.50
Executive Plan options	**7.68**	6.68

Additional information in respect of share options

Options outstanding and exercisable and their weighted average exercise prices for the respective ranges of exercise prices and years at 31 March 2008 are as follows:

	Weighted average exercise price of exercisable options £	Number exercisable	Weighted average exercise price of outstanding options £	Number outstanding	Exercise price per share pence	Normal dates of exercise years
Executive plan	3.76	7,000	3.76	7,000	375.75	2002-2009
	-	-	5.27	16,000	526.00-531.50	2004-2011
	4.40	69,000	4.40	69,000	434.25-460.25	2000-2013
	4.34	76,000	4.51	92,000		

31. Share options and reward plans continued

Share-based payment charges

The charge to the income statement for the year ended 31 March 2008 was £6m (2007: £5m).

Awards under share option plans

The average share prices at the date of options being granted, the average price of the options granted and their estimated average fair values during each of the two financial years ended 31 March were as follows:

	2008	2007
Average share price	**846.0p**	746.0p
Average exercise price	**655.0p**	558.0p
Average fair value	**189.3p**	166.5p

These amounts have been calculated in respect of options where the exercise price is less than the market price at the date of grant.

The fair values of the options granted were estimated using the following principal assumptions:

	2008	2007
Dividend yield (%)	**4.5**	4.5
Volatility (%)	**15.6-18.9**	15.6-18.9
Risk-free investment rate (%)	**4.2**	4.2
Average life (years)	**3.7**	3.6

The fair values of awards under the Sharesave scheme have been calculated using the Black-Scholes European model for awards made prior to 1 April 2006. This is considered appropriate given the short exercise window of sharesave options. The fair values of awards made in 2007 onwards have been calculated by reference to the prior year's Black-Scholes European model calculation.

Volatility was derived based on the following and is assumed to revert from its current implied level to its long run mean based historical volatility under (ii) below:

(i) implied volatility in traded options over National Grid plc's shares;

(ii) historical volatility of National Grid plc's shares from October 2002 (the date of the business combination of National Grid Group plc and Lattice Group plc), and

(iii) implied volatility of comparator companies where options in their shares are traded.

Awards under other share scheme plans

The average share prices and fair values at the date share awards were granted during each of the financial years ended 31 March were as follows:

	2008	2007
Average share price	**766.9p**	594.0p
Average fair value	**522.8p**	403.1p

The fair values of the awards granted were estimated using the following principal assumptions:

	2008	2007
Dividend yield (%)	**4.4**	4.4
Volatility (%)	**19.9**	19.9
Risk-free investment rate (%)	**4.1**	4.1

Fair values have been calculated using a Monte Carlo simulation model for awards with total shareholder return performance conditions made prior to 1 April 2006. The fair value of awards made in 2007 onwards has been calculated by reference to the prior year's Monte Carlo simulation model calculation. Fair values of awards with performance conditions based on earnings per share have been calculated using the share price at date of grant less the present value of dividends foregone during the performance period.

For other share scheme awards, where the primary vesting condition is that employees complete a specified number of years service, the fair value has been calculated as the share price at date of grant, adjusted to recognise the extent to which participants do not receive dividends over the vesting period. Volatility for share awards has been calculated on the same basis as used for share options as described above.

32. Ultimate parent company

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

33. Subsidiary undertakings

	Principal activity	Holding
National Grid Gas Finance (No 1) plc	Financing	100%
National Grid Metering Limited	Gas metering services	100%
British Transco International Finance BV (incorporated in the Netherlands)	Financing	100%
British Transco Finance Inc. (incorporated in the US)	Financing	100%
British Transco Capital Inc. (incorporated in the US)	Financing	100%
British Transco Finance (No. 1) Limited	Financing	100%
British Transco Finance (No. 2) Limited	Financing	100%
British Transco Finance (No. 3) Limited	Financing	100%
British Transco Finance (No. 5) Limited	Financing	100%
xoserve Limited	Gas transportation transaction services	56.57%

A full list of all subsidiaries and associated undertakings is available from the Company Secretary of the Company.

Company accounting policies

for the year ended 31 March 2008

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

These individual financial statements of the Company have been prepared in accordance with applicable UK accounting and financial reporting standards and the Companies Act 1985.

The individual financial statements of the Company have been prepared on a historical cost basis, except for the revaluation of financial instruments.

These financial statements are presented in pounds sterling because that is the currency of the primary economic environment in which the Company operates.

The Company has not presented its own profit and loss account as permitted by section 230 of the Companies Act 1985. The Company has taken the exemption from preparing a cash flow statement under the terms of FRS 1 (revised 1996) 'Cash Flow Statements'.

In accordance with exemptions under FRS 8 'Related party disclosures', the Company has not disclosed transactions with related parties, as the Company's financial statements are presented together with its consolidated financial statements. Furthermore, in accordance with exemptions under FRS 29 'Financial Instruments: Disclosures', the Company has not presented the financial instruments disclosures required by the standard, as disclosures which comply with the standard are included in the consolidated financial statements.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

B. Foreign currencies

Transactions in currencies other than the functional currency of the Company are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at closing exchange rates. Gains and losses arising on retranslation of monetary assets and liabilities are included in the profit and loss account.

C. Tangible fixed assets

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

Tangible fixed assets include assets in which the Company's interest comprises legally protected statutory or contractual rights of use.

Additions represent the purchase or construction of new assets, extensions to, or significant increases in, the capacity of tangible fixed assets.

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

Depreciation is not provided on freehold land or assets in the course of construction. Other tangible fixed assets are depreciated principally on a straight-line basis, at rates estimated to write off their book values over their estimated useful economic lives. In assessing estimated useful economic lives, which are reviewed on a regular basis, consideration is given to any contractual arrangements and operational requirements relating to particular assets. Unless otherwise determined by operational requirements, the depreciation periods for the principal categories of tangible fixed assets are, in general, as shown in the table below:

Depreciation periods	Years
Freehold and leasehold properties	up to 50
Plant and machinery:	
– Mains, services and regulating equipment	30 to 100
– Meters and metering equipment	5 to 18
Motor vehicles and office equipment	3 to 10

D. Fixed asset investments

Investments held as fixed assets are stated at cost less any provisions for impairment.

E. Impairment of fixed assets

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

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

F. Taxation

Current tax for the current and prior periods is provided at the amount expected to be paid (or recovered) using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date. Current tax assets and liabilities arising from transfer pricing adjustments, which are expected to be fully recovered through group relief, are initially provided for when tax returns are submitted to the tax authorities.

Deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or the right to pay less tax, at a future date, at tax rates expected to apply when the timing differences reverse, based on tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

G. Stocks

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

H. Environmental costs

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

I. Revenue

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

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

J. Replacement expenditure

Replacement expenditure is recognised within operating costs and represents the cost of planned maintenance of mains and services assets by replacing or lining sections of pipe. This expenditure is principally undertaken to repair and maintain the safety of the network and is written off as incurred. Expenditure that enhances the performance of mains and services assets is treated as an addition to tangible fixed assets.

K. Pensions

The substantial majority of the Company's employees are members of the defined benefit section of the National Grid UK Pension Scheme. There is no contractual arrangement or stated policy for charging the net defined benefit cost of the scheme to the Company. Accordingly, the Scheme is recognised in these Company financial statements as if it were a defined contribution scheme. The pension charge for the year represents the contributions payable to the Scheme for the period. A share of the assets and liabilities or the actuarial gains and losses of the Scheme are not recognised in these Company financial statements.

L. Leases

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

M. Financial instruments

Financial assets, liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities and is recorded at the proceeds received, net of direct issue costs.

Loans receivable are carried at amortised cost using the effective interest rate method less any allowance for estimated impairments. A provision is established for impairments when there is objective evidence that the Company will not be able to collect all amounts due under the original terms of the loan. Interest income, together with losses when the loans are impaired, is recognised on an effective interest rate basis in the profit and loss account.

Current asset financial investments are recognised at fair value plus directly related incremental transaction costs and are subsequently carried at fair value on the balance sheet. Changes in the fair value of investments classified as available-for-sale are recognised directly in equity, until the investment is disposed of or is determined to be impaired. At this time the cumulative gain or loss previously recognised in equity is included in net profit or loss for the period. Investment income on investments classified as available-for-sale is recognised in the profit and loss account as it accrues.

Borrowings, which include interest-bearing loans, UK Retail Price Index (RPI) linked debt and overdrafts, are recorded at their initial fair value which normally reflects the proceeds received, net of direct issue costs less any repayments. Subsequently these are stated at amortised cost, using the effective interest rate method. Any difference between proceeds and the redemption value is recognised over the term of the borrowing in the profit and loss account using the effective interest rate method.

Derivative financial instruments are recorded at fair value, and where the fair value of a derivative is positive, it is carried as a derivative asset and where negative, as a liability. Assets and liabilities on different transactions are only netted if the transactions are with the same counterparty, a legal right of set-off exists and the cash flows are intended to be settled on a net basis. Gains and losses arising from changes in fair value are included in the profit and loss account in the period they arise.

Where derivatives are embedded in other financial instruments that are closely related to those instruments, no adjustment is made with respect to such derivative clauses. Otherwise the derivative is recorded separately at fair value on the balance sheet.

N. Hedge accounting

The Company enters into derivative financial instruments (‘derivatives’) and non-derivative financial instruments in order to manage interest rate and foreign currency exposures, with a view to managing these risks associated with the Company’s underlying business activities and the financing of those activities. The principal derivatives used include interest rate swaps, forward rate agreements, currency swaps and forward foreign currency contracts.

Hedge accounting allows derivatives to be designated as a hedge of another (non-derivative) financial instrument, to mitigate the impact of potential volatility in the profit and loss account. The Company uses two hedge accounting methods.

Firstly, changes in the carrying value of financial instruments that are designated and effective as hedges of future cash flows (‘cash flow hedges’) are recognised directly in equity and any ineffective portion is recognised immediately in the profit and loss account. Amounts deferred in equity in respect of cash flow hedges are subsequently recognised in the profit and loss account in the same period in which the hedged item affects net profit or loss.

Secondly, changes in the carrying value of financial instruments that are designated as hedges of the changes in the fair value of assets or liabilities (‘fair value hedges’) are recognised in the profit and loss account. An offsetting amount is recorded as an adjustment to the carrying value of hedged items, with a corresponding entry in the profit and loss account, to the extent that the change is attributable to the risk being hedged and that the fair value hedge is effective.

Changes in the fair value of derivatives that do not qualify for hedge accounting are recognised in the profit and loss account as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gains or losses relating to cash flow hedges recognised in equity are initially retained in equity and subsequently recognised in the profit and loss account in the same periods in which the previously hedged item affects net profit or loss. For fair value hedges the cumulative adjustment recorded to its carrying value at the date hedge accounting is discontinued is amortised to the profit and loss account using the effective interest rate method.

If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the profit and loss account immediately.

O. Parent Company guarantees

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

P. Share-based payments

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

Q. Restructuring costs

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

R. Emission allowances

Emission allowances, which relate to the emissions of carbon dioxide, are recorded as an intangible asset within current assets and are initially recorded at cost, and subsequently at the lower of cost and net realisable value. For allocations of emission allowances granted by the UK Government, cost is deemed to be equal to fair value at the date of allocation. Receipts of such grants are treated as deferred income and are recognised in the income statement in the period in which carbon dioxide emissions are made. A provision is recorded in respect of the obligation to deliver emission allowances and charges are recognised in the income statement in the period in which carbon dioxide emissions are made.

S. Dividends

Dividends are recognised in the financial year in which they are approved.

Company balance sheet

at 31 March

	Notes	2008 £m	2007 £m
Fixed assets			
Tangible assets	6	**6,539**	5,866
Investments	7	**17**	17
		6,556	5,883
Current assets			
Stocks	8	**31**	28
Debtors (amounts falling due within one year)	9	**377**	362
Debtors (amounts falling due after more than one year)	9	**5,611**	5,613
Derivative financial instruments (amounts falling due within one year)	10	**81**	9
Derivative financial instruments (amounts falling due after more than one year)	10	**101**	65
Current asset investments		**524**	477
		6,725	6,554
Creditors (amounts falling due within one year)			
Borrowings	13	**(1,741)**	(2,288)
Derivative financial instruments		**(27)**	(11)
Other creditors		**(877)**	(910)
	11	**(2,645)**	(3,209)
Net current assets		**4,080**	3,345
Total assets less current liabilities		**10,636**	9,228
Creditors (amounts falling due after more than one year)			
Borrowings	13	**(5,057)**	(3,435)
Derivative financial instruments		**(83)**	(83)
Other creditors		**(689)**	(672)
	12	**(5,829)**	(4,190)
Provisions for liabilities and charges	14	**(900)**	(912)
Net assets employed		**3,907**	4,126
Capital and reserves			
Called up share capital	15	**45**	45
Share premium account	16	**204**	204
Cash flow hedge reserve	16	**(35)**	(49)
Other reserves	16	**1,332**	1,332
Profit and loss account	16	**2,361**	2,594
Total shareholders' funds		**3,907**	4,126

Commitments and contingencies are shown in note 17 to the Company financial statements.

The notes on pages 85 to 91 form part of the individual financial statements of the company, which were approved by the Board of Directors on 5 June 2008 and were signed on its behalf by:

Mark Fairbairn Director

Adam Wiltshire Director

Notes to the company accounts

1. Adoption of new accounting standards

New financial reporting standards (FRS) and abstracts adopted in 2007/08

During the year the Company has adopted the following FRSs and abstracts. None of these had a material impact on the consolidated results or assets and liabilities.

Amendments to FRS 3 on reporting financial performance	Removes inconsistencies between FRS 3 and both FRS 26 'Financial instruments: recognition and measurement' and FRS 23 'The effects of changes in foreign exchange rates', in particular as regards recycling to the profit and loss account of gains and losses and exchange differences previously recognised in the statement of recognised gains and losses.
Amendment to FRS 26 on financial instruments: measurement - recognition and derecognition	Implements the recognition and derecognition material in IAS 39. The requirements of FRS 5, 'Reporting the substance of transactions' are superseded for transactions that fall within FRS 26's scope, but FRS 5 continues to apply to transactions in non-financial assets and liabilities.
UITF Abstract 42 on reassessment of embedded derivatives	Prohibits reassessment of the treatment of embedded derivatives subsequent to initial recognition unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required.
UITF Abstract 44 on group and treasury share transactions	Provides guidance on whether share-based transactions involving treasury shares or involving group entities (for instance, options over a parent's shares) should be accounted for as equity-settled or cash-settled.

New FRS not yet adopted

The Company has yet to adopt the following FRS. However, it is not expected to have a material impact on the Company results or assets and liabilities.

Amendment to FRS 20 on share-based payment	Clarifies the definition of vesting conditions and the accounting treatment of cancellations. Vesting conditions are defined as either service conditions or performance conditions. Cancellations by employees are accounted for in the same way as cancellations by the Company. It is expected that the amendment to FRS 20 will be adopted on 1 April 2009.

2. Auditors' remuneration

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

	2008 £m	2007 £m
Audit services		
Audit fee of company	**0.9**	0.4
Other services		
Other services supplied pursuant to legislation	**0.4**	0.4

Other services supplied pursuant to legislation represents fees payable for services in relation to engagements which are required to be carried out by the auditor. In particular, this includes fees for audit reports on regulatory returns and fees for reports under section 404 of the US Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley).

3. Number of Employees

	2008 Average Number	2007 Average Number
United Kingdom		
Continuing operations	5,691	5,877

4. Directors' emoluments

Details of Directors' emoluments are provided in note 3(d) to the consolidated financial statements.

5. Pensions

Substantially all the Company's employees are members of the defined benefit section of the National Grid UK Pension Scheme . There is no contractual arrangement or stated policy for charging the net defined benefit cost of the scheme to the Company. Accordingly, the Company accounts for the scheme as if it were a defined contribution scheme.

The disclosures required by FRS 17 are provided in notes 5 and 28 to the consolidated financial statements.

6. Tangible fixed assets

	Land and buildings £m	Plant and machinery £m	Assets in the course of construction £m	Motor vehicles and office equipment £m	Total £m
Cost at 1 April 2007	79	8,085	768	672	9,604
Additions	13	202	790	28	1,033
Disposals	(2)	(14)	-	(12)	(28)
Reclassifications	2	964	(1,007)	41	-
Cost at 31 March 2008	92	9,237	551	729	10,609
Depreciation at 1 April 2007	(24)	(3,232)	-	(482)	(3,738)
Depreciation charge for the year	(5)	(291)	-	(55)	(351)
Disposals	1	6	-	12	19
Depreciation at 31 March 2008	(28)	(3,517)	-	(525)	(4,070)
Net book value at 31 March 2008	**64**	**5,720**	**551**	**204**	**6,539**
Net book value at 31 March 2007	55	4,853	768	190	5,866

The net book value of land and buildings comprised:

	2008 £m	2007 £m
Freehold	**41**	44
Short leasehold (under 50 years)	**23**	11
	64	55

The cost of tangible fixed assets at 31 March 2008 included £96m (2007: £51m) relating to interest capitalised.

Included within creditors (amounts falling due within one year) and creditors (amounts falling due after more than one year) are contributions to the cost of tangible fixed assets amounting to £19m (2007: £18m) and £631m (2007: £614m) respectively.

7. Fixed asset investments

	Shares in subsidiary undertakings £m
Cost at 1 April 2007 and 31 March 2008	17

The names of the principal subsidiary undertakings are included in note 33 to the consolidated financial statements.

8. Stocks

	2008 £m	2007 £m
Raw materials and consumables	**31**	28

9. Debtors

	2008 £m	2007 £m
Amounts falling due within one year:		
Trade debtors	**32**	47
Amounts owed by fellow subsidiary undertakings	**122**	121
Other debtors	**40**	35
Prepayments and accrued income	**183**	159
	377	362
Amounts falling due after more than one year:		
Other debtors	**-**	2
Amounts owed by immediate parent undertaking	**5,611**	5,611
	5,611	5,613
Total debtors	**5,988**	5,975

10. Derivative financial instruments

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

	2008 Assets £m	2008 Liabilities £m	2008 Total £m	2007 Assets £m	2007 Liabilities £m	2007 Total £m
Current	**81**	**(27)**	**54**	9	(11)	(2)
Non- current	**101**	**(83)**	**18**	65	(83)	(18)
	182	**(110)**	**72**	74	(94)	(20)

For each class of derivative financial instrument, our exposure, based on the sterling equivalent notional value of the pay leg is as follows:

	2008 £m	2007 £m
Interest rate swaps	**(2,800)**	(2,109)
Cross-currency interest rate swaps	**(906)**	(1,441)
Foreign exchange forward contracts	**(176)**	(31)
	(3,882)	(3,581)

11. Creditors (amounts falling due within one year)

	2008 £m	2007 £m
Derivative financial instruments (note 10)	**27**	11
Borrowings (note 13)	**1,741**	2,288
Trade creditors and accruals	**417**	397
Amounts owed to Group undertakings	**39**	11
Amounts owed to fellow subsidiary undertakings	**239**	287
Corporation tax	**27**	34
Social security and other taxes	**87**	96
Other creditors	**22**	23
Deferred income	**46**	62
	2,645	3,209

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

	2008 £m	2007 £m
Derivative financial instruments	**83**	83
Borrowings (note 13)	**5,057**	3,435
Trade creditors	**-**	6
Other creditors	**3**	3
Deferred income	**686**	663
	5,829	4,190

Deferred income mainly comprises contributions to capital projects.

13. Borrowings

The following table analyses the company's borrowings:

	2008 £m	2007 £m
Amounts falling due within one year:		
Bank loans and overdrafts	**47**	31
Bonds	**631**	319
Borrowings from Group undertakings	**480**	1,516
Borrowings from fellow subsidiary undertakings	**581**	419
Other loans	**2**	3
	1,741	2,288
Amounts falling due after more than one year:		
Bank loans	**584**	380
Bonds	**4,210**	2,727
Borrowings from Group undertakings	**151**	228
Other loans	**112**	100
	5,057	3,435
Total borrowings	**6,798**	5,723
Total borrowings are repayable as follows:		
In one year or less	**1,741**	2,288
More than one year, but not more than two years	**489**	459
More than two years, but not more than three years	**-**	487
More than three years, but not more than four years	**-**	-
More than four years, but not more than five years	**215**	-
More than five years, other than by instalments	**4,353**	2,489
	6,798	5,723

The notional amount outstanding of the Company's debt portfolio at 31 March 2008 was £6,576m (2007: £5,586m).

14. Provisions for liabilities and charges

	Environmental £m	Emissions £m	Restructuring £m	Deferred Taxation £m	Other £m	Total £m
At 1 April 2007	44	1	20	806	41	912
Charged/(credited) to profit and loss account	-	4	23	(23)	7	11
Transferred to reserves	-	-	-	1	-	1
Utilised	(1)	-	(22)	-	(2)	(25)
Unwinding of discount	1	-	-	-	-	1
At 31 March 2008	**44**	**5**	**21**	**784**	**46**	**900**

The environmental provision represents the net present value of the estimated statutory decontamination costs of old gas manufacturing sites (discounted using a nominal rate of 5.0%). The anticipated timing of the cash flows for statutory decontamination cannot be predicted with certainty, but they are expected to be incurred over the next 50 years.

There are a number of uncertainties that affect the calculation of the provision for gas site decontamination, including the impact of regulation, the accuracy of the site surveys, unexpected contaminants, transportation costs, the impact of alternative technologies and changes in the discount rate. The Company has made its best estimate of the financial effect of these uncertainties in the calculation of the provision, but future material changes in any of the assumptions could materially impact on the calculation of the provision and hence the profit and loss account.

The undiscounted amount of the provision at 31 March 2008 relating to gas site decontamination was £69m (2007: £70m), being the undiscounted best estimate of the liability having regard to the uncertainties referred to above.

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

At 31 March 2008, £6m of the total restructuring provision (2007: £7m) consisted of provisions for the disposal of surplus leasehold interests and rates payable on surplus properties. The remainder of the restructuring provision related to business reorganisation costs, largely to be paid within the next financial year.

Other provisions at 31 March 2008 include £17m (2007: £24m) in respect of property transfer costs related to the sales of four UK gas distribution networks and £18m (2007: £17m) in respect of employer liability claims. The payment dates for the property transfer costs are uncertain but should largely be over the next three years. In accordance with insurance industry practice the estimates for the employer liability claims are based on experience from previous years and, therefore, there is no identifiable payment date.

Deferred taxation comprises:

	2008 £m	2007 £m
Accelerated capital allowances	**784**	803
Other timing differences	**-**	3
	784	806

Deferred tax assets in respect of capital losses of £18m (2007:£nil) have not been recognised as their future recovery is uncertain or not currently anticipated. The capital losses are available to carry forward indefinitely. The capital losses can be offset against specific types of future capital gains.

There are no other significant unrecognised deferred tax assets or liabilities (2007: £nil).

15. Share capital

	Number of shares 2008 millions	Number of shares 2007 millions	2008 £m	2007 £m
At 31 March 2007 and 2008 - ordinary shares of $1^{2}/_{15}$p each				
Allotted, called up and fully paid	**3,944**	3,944	**45**	45
Authorised	**6,052**	6,052	**69**	69

National Grid Gas plc is a wholly owned subsidiary undertaking of National Grid Gas Holdings plc.

16. Reserves

	Cash flow hedge reserve £m	Share premium account £m	Capital redemption reserve £m	Profit and loss account £m
At 1 April 2007	(49)	204	1,332	2,594
Profit for the year	-	-	-	258
Dividends	-	-	-	(500)
Net expense recognised directly in reserves	14	-	-	-
Share-based payments	-	-	-	5
Tax on share-based payments	-	-	-	4
At 31 March 2008	**(35)**	**204**	**1,332**	**2,361**

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

The Company has not presented its own profit and loss account as permitted by section 230 of the Companies Act 1985. The Company's profit after taxation was £258m (2007: £94m).

17. Commitments and contingencies

a) Future capital expenditure

As at 31 March 2008, the Company had placed contracts for capital expenditure (tangible fixed assets) amounting to £460m (2007: £753m).

b) Lease commitments

At 31 March 2008, the Company's total operating lease commitments for the financial year ending 31 March 2009 amounted to £11m (2007 commitments for 2008: £10m) and are analysed by lease expiry date as follows:

	Land and buildings		Other		Total	
	2008 £m	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m
Expiring:						
In one year or less	**1**	-	**1**	2	**2**	2
In more than one year, but not more than five years	**1**	2	**1**	1	**2**	3
In more than five years	**6**	5	**1**	-	**7**	5
	8	7	**3**	3	**11**	10

The Company's total commitments under non-cancellable operating leases were payable as follows:

	2008 £m	2007 £m
Amounts:		
In one year or less	**11**	10
In more than one year, but not more than two years	**10**	9
In more than two years, but not more than three years	**8**	7
In more than three years, but not more than four years	**8**	5
In more than four years, but not more than five years	**7**	5
In more than five years	**38**	32
	82	68

c) Other commitments and contingencies

The value of other commitments and contingencies at 31 March 2008 amounted to £84m (2007: £213m), including a performance guarantee of £5m (2007: £6m) relating to certain property obligations of a National Grid group undertaking, and BG Group related commitments and contingencies amounting to £nil (2007: £7m).

d) Parent company loan guarantees on behalf of subsidiary undertakings

The Company has guaranteed the repayment of principal sums, any associated premium and interest on specific loans due from its financial subsidiary undertakings to third parties. At 31 March 2008, the sterling equivalent amounted to £1,159m (2007: £1,108m).

e) Litigation and claims

On 28 February 2008, the Gas and Electricity Markets Authority imposed a £41.6m fine on National Grid Gas plc for infringement of the Competition Act 1998 in relation to a number of metering contracts entered into with gas suppliers in 2004. We believe that the contracts do not infringe competition law, were entered into voluntarily by gas suppliers and Ofgem was consulted throughout the process of contract development and negotiation. Therefore, we have lodged an appeal with the Competition Appeal Tribunal. The fine has been suspended pending the outcome of the appeal and no provision has been made in the accounts.

We remain convinced that The Company has not breached the Competition Act 1998, that our position will be upheld and the fine reversed on appeal.

18. Related parties

Subsequent to the sale of Advantica Limited, a former fellow subsidiary of National Grid plc, on 31 August 2007, the Company purchased services amounting to £9m from Advantica.

Definitions

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

bcm
Billion cubic metres

FRS
UK Financial Reporting Standard

GAAP
Generally accepted accounting principles

GW
Gigawatt, 10^9 watts

GWh
Gigawatt hours

HSE
Health and Safety Executive

IAS
International Accounting Standard

IFRIC
International Financial Reporting Standards Interpretations Committee

IFRS
International Financial Reporting Standard

KPI
Key Performance Indicator

LNG
Liquefied natural gas

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

mcm
Million cubic metres

National Grid
National Grid plc, the ultimate parent company of National Grid Gas plc and its controlling party

Ofgem
The Office of Gas and Electricity Markets

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

TW
Terawatt, 10^{12} watts

TWh
Terawatt hours

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