# National Grid Electricity Transmission plc
# Transmission business
# Regulatory accounting statements 2008/09

Company Number 2366977

nationalgrid

# Contents



**Note on use of terms and abbreviations**

Within these accounts, National Grid Electricity Transmission plc is referred to by the abbreviation 'NGET', and National Grid plc, its ultimate parent company, by the abbreviation 'National Grid'. References to NGET refer to National Grid Electricity Transmission plc itself, or National Grid Electricity Transmission plc and its subsidiaries collectively, as the context requires. The regulated Transmission business carried on by National Grid Electricity Transmission plc is referred to as 'the Transmission business'. A full glossary of terms used is included on page 71.

# About these regulatory accounting statements

National Grid Electricity Transmission plc (NGET) is the holder of an Electricity Transmission Licence granted under the Electricity Act 1989. Under Condition B1 of this licence, NGET is required to prepare and publish annual regulatory accounting statements setting out the financial position and performance of the regulatory business covered by the licence.

**Definition of regulatory businesses and scope of regulatory accounting statements**

The regulatory business reported on in these regulatory accounting statements is the Transmission business as defined in the licence under which they are prepared. This business differs in some respects from the Transmission business as reported on in the statutory accounts of NGET.

The financial statements on pages 40 to 70 which form part of these regulatory accounting statements are only in respect of the regulated Transmission business of NGET, and exclude transactions relating to the company's other activities.

The Operating and Financial Review on pages 2 to 22 refers, where relevant, to the regulated Transmission business. In some areas, the matters covered by the Operating and Financial Review cannot be separately identified as relating to the regulated Transmission business or to other activities of NGET. For these areas, the Operating and Financial Review relates to the activities of NGET as a whole.

**Relationship of regulatory accounting statements with statutory accounts**

The financial information contained in these regulatory accounting statements does not constitute statutory accounts within the meaning of section 240 of the Companies Act 1985. Statutory accounts for NGET for the year ended 31 March 2009, to which the financial information relates, have been delivered to the registrar of Companies.

The auditors have made a report under Section 235 of the Companies Act 1985 on those statutory accounts which was unqualified and did not contain a statement under Section 237(2) or (3) of the Act. The auditors' opinion on the NGET statutory accounts is addressed to, and for the benefit of, the members of NGET and not for any other person or purpose. The auditors have clarified, in giving their opinion on those statutory accounts, that it 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. In giving their opinion, they do not accept or assume responsibility for any other purposes or to any other person to whom their audit report on the statutory accounts is shown or into whose hands it may come save where expressly agreed by their prior consent in writing.

The statutory accounts of NGET, and of the ultimate parent company National Grid plc (National Grid), can be obtained from the Company Secretary's Office, National Grid plc, 1-3 The Strand, London WC2N 5EH, and from the website of National Grid plc at www.nationalgrid.com.

**Basis of preparation of regulatory accounting statements**

These regulatory accounting statements contain arbitrary apportionments of certain revenues, costs, assets, liabilities and shareholder's equity of NGET which are not specifically attributable to the Transmission business. Further details of these items are provided under Basis of preparation on page 32.

# Operating and Financial Review

**Operating and Financial Review contents**



This Operating and Financial Review describes the main trends and factors underlying the development, performance and position of the Transmission business reported in these regulatory accounting statements, and where relevant of NGET during the year ended 31 March 2009 as well as those likely to affect its 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

NGET's principal operations are the ownership and operation of regulated electricity transmission networks in Great Britain.

The business reported on in these regulatory accounting statements is the regulated Transmission business carried on by NGET. This business involves the transmission of electricity within the UK as owner and operator of the high-voltage electricity transmission network in England and Wales and operator of the electricity transmission networks in Scotland.

The business comprises the following principal activities:

| | |
|---|---|
| **Electricity transmission owner** | Owns the electricity transmission system in England and Wales, comprising approximately 7,200 kilometres of overhead line, about 675 kilometres of underground cable and 337 substations at 244 sites. |
| **Electricity system operator** | Great Britain System Operator, responsible for managing the operations of both the England and Wales transmission system owned by NGET and also the two high-voltage electricity transmission networks in Scotland.<br><br>Day-to-day operation of the Great Britain electricity transmission system involves the continuous real-time matching of demand and generation output, ensuring the stability and security of the power system and the maintenance of satisfactory voltage and frequency. |

As electricity transmission owner, NGET owns and maintains the physical assets, develops the network to accommodate new connections and disconnections, and manages a programme of asset replacement and investment to ensure the long-term reliability of the network.

As electricity system operator, NGET undertakes a range of activities necessary for the successful, efficient delivery, in real-time, of secure and reliable energy. This involves the continuous real-time balancing of supply and demand, and balancing services that include commercial arrangements with market participants that enable electricity demand or generation output to be varied.

### History

NGET originated from the restructuring of the electricity industry in 1990.

| **Key milestones** | |
|---|---|
| **1990** | Electricity transmission network in England and Wales transferred to National Grid Company on electricity privatisation |
| **1995** | National Grid listed on the London Stock Exchange |
| **2002** | Merger of National Grid Group and Lattice Group to form National Grid Transco |
| **2005** | National Grid adopted as our brand name, with National Grid Company renamed National Grid Electricity Transmission plc |
| **2006** | Disposal of interconnector business |

# Organisation and structure

NGET is a subsidiary of National Grid plc (National Grid).

The continuing operations of National Grid are organised and managed by global lines of business, which includes Transmission. The day-to-day management of National Grid's operations, and the execution of strategy as approved by the Board of National Grid, is carried out by the National Grid Executive Committee which is composed of the Executive Directors of National Grid and its Company Secretary and General Counsel.

The Electricity Transmission business of NGET forms part of the global Transmission business of National Grid.

The overall management and governance of NGET is the responsibility of its Board of Directors. The Board of Directors has established a number of committees and sub-committees of the Board that assist it in its activities. These include the Transmission Executive Committee.

The day-to-day management of NGET's Electricity Transmission business is carried on by the Transmission Executive Committee. This committee is chaired by Nick Winser, who is a Director of NGET, and who also sits on the Board and Executive Committee of National Grid and is the National Grid Executive Director responsible for the global Transmission business.

More information on corporate governance within NGET is provided on page 23.

More information on the business activities, organisation, structure, management and governance of National Grid can be found in the National Grid Annual Report and Accounts 2008/09 and on the website at www.nationalgrid.com. See note 26 on page 67 for further details of where these reports can be obtained.

# External market and regulatory environment

## Markets in which NGET operates

The principal market in which NGET operates is the electricity market in the UK.

The supply of electricity in the UK is competitive in that consumers can contract with different suppliers to obtain the electricity they require. Those suppliers are then responsible for sourcing that electricity from generators or importers as appropriate, as well as arranging for delivery through physical networks. These networks, including the ones NGET operates, are monopolies in their local areas as, for the majority of consumers, there are no alternative methods of receiving electricity.

**Electricity delivery in the UK**

Electricity is transported through electricity transmission networks to regional electricity distribution networks which then deliver electricity to consumers on behalf of suppliers. Certain end customers, primarily large industrial users, receive electricity direct from the transmission network.

NGET is the owner and operator of the high-voltage electricity transmission network in England and Wales and the operator, but not owner, of the two electricity transmission networks in Scotland. NGET charges energy suppliers and electricity generators for its services. These charges are incorporated into the prices charged to end consumers.

The other principal electricity infrastructure owners and operators in the UK are EDF group, which owns three electricity distribution networks, Scottish & Southern Energy, Iberdrola, E.ON, Western Power Distribution and MidAmerican Energy, each of which own two electricity distribution networks, and Electricity North West, which owns one electricity distribution network. Scottish & Southern and Iberdrola also each own an electricity transmission network in Scotland, which NGET operates in both cases.

## Regulation

Due to its position in and importance to the economy in which it operates, NGET's electricity transmission business is subject to UK and European Union laws and regulations.

NGET's businesses are also subject to safety legislation which is enforced by the Health and Safety Executive (HSE).

NGET is the sole holder of an electricity transmission licence for England and Wales. This licence also covers its role as system operator for the transmission networks in Great Britain. Under the Electricity Act 1989, NGET has a duty to develop and maintain an efficient, coordinated and economical system of electricity transmission and to facilitate competition in the supply and generation of electricity.

Economic regulation of the business 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.

Ofgem sets price controls in respect of the amounts that can be recovered by the owners and operators of electricity network infrastructure in the UK.

There are two price controls for NGET's electricity transmission business. These price controls provide a financial incentive to invest, as a return is received on efficiently incurred capital expenditure that increases the regulatory asset base, and also provide incentives by which NGET can gain or lose for performance in managing system operation, controlling internal costs and for service quality.

These controls are reviewed every five years. The current price control for electricity transmission activities covers the period 1 April 2007 to 31 March 2012.

NGET accepted Ofgem's final proposals for the system operator scheme that applied to the year ended 31 March 2009, and has also accepted their proposal for the one year schemes from 1 April 2009.

The key elements of the current price control are that NGET earns a 4.4% post-tax real rate of return on regulatory asset value (equivalent to a 5.05% vanilla return), a £3.5 billion baseline five year capital expenditure allowance and a £0.9 billion five year operating expenditure allowance.

The charges NGET makes for access to its electricity transmission system are determined by a formula linked to the UK Retail Prices Index (RPI). This formula is based upon Ofgem's estimates of NGET's operating expenditure and capital expenditure, together with an allowed rate of return.

In addition NGET is subject to a number of incentives that can adjust transmission network revenue. These include the transmission network reliability scheme and the sulphur hexafluoride ($SF_6$) incentive scheme.

NGET's system operation activities are subject to financial incentive schemes to promote efficiency. If networks are operated more efficiently than Ofgem's forecasts, revenues can be increased, with penalties for reductions in performance.

There is also a balancing services incentive scheme that covers the external costs incurred in balancing the system. For 2009/10, NGET has accepted an incentive scheme with a cost target between £600 million and £630 million, such that 25% of any savings below £600 million are retained (up to a cap of £15 million) and 15% of any costs in excess of £630 million are lost (down to a collar of £15 million).

In addition, as a public company with securities listed on the London Stock Exchange, NGET is subject to regulation by the UK Financial Services Authority and by the exchange.

# Current and future developments

## External market developments

### Market structure and ownership

There have been no significant changes in the structure of the UK electricity infrastructure market or in ownership during 2008/09.

### Energy market developments

Despite significant declines in wholesale energy prices since mid 2008, high consumer energy prices have been experienced in the UK during the current year. This has led to significant increases in bills to consumers for their energy supplies. The combination of higher energy prices and the current economic climate has led to a reduction in demand.

The UK market continues to undergo developments driven by new sources of electricity generation, including renewables, and increased focus on security of supply. The energy sector faces significant challenges relating to meeting Government targets on renewable generation, and significant levels of retirement of the current power generation fleet.

National Grid has led a major assessment of the UK electricity transmission system and the need to ensure that renewable targets can be met. The assessment considered the potential locations and volume of renewable generation and the network requirements to connect it.

March 2009 saw the completion of the competitive tender process for round three of the offshore wind generation leasing programme by the Crown Estate for the nine offshore development zones. These zones have the potential to deliver up to 25GW of offshore wind generation.

This year has seen a significant increase in nuclear connection requests. In April 2009 the UK Government released its list of eleven potential sites for the development of new nuclear power plants.

These changes are expected to impact all of NGET's electricity transmission networks, requiring significant investment to link new generation plants with domestic, business and industrial consumers.

## Regulatory developments

During the year ended 31 March 2009, there were a number of legislative changes in the UK including the introduction of new consumer arrangements, which incorporate an energy ombudsman scheme to deal with consumer complaints and a new Energy Act facilitating a roll out of smart meters in the UK by 2020.

In March 2008 Ofgem announced a review of the current RPI-X based regulatory framework. This is a two year assessment of the current regulatory regime and its ability to address the challenges facing energy networks in the future. The outcome of this review is unlikely to impact NGET's current regulatory settlements, but could influence future price controls from 2012.

In December 2008 the European Union approved a number of environmental proposals. Legally binding national targets have been established that dictate the proportion of energy production to be provided from renewable sources by 2020. For the UK the target is 15%. In order to achieve this it is believed the proportion of electricity generated by renewable sources will need to rise to around 35%. At present it is unclear specifically how these targets will impact NGET; however, they will significantly influence the UK regulatory framework and UK price control reviews in the future.

The European Commission's third package of legislative proposals for European gas and electricity markets has been submitted for final adoption by the EU Council of Ministers, following approval by the European Parliament in April 2009. The new legislation consists of two directives on rules for the internal gas and electricity markets, two regulations on conditions for access to those markets, and one regulation establishing an Agency for the Cooperation of Energy Regulators. The original legislation, published in September 2007, contained measures to force energy companies to unbundle their transmission businesses from supply and generation activities. The revised draft proposals include alternatives to full unbundling. Adoption is expected in summer 2009.

## Other developments

**Connection of renewable generation**

NGET is working with the UK electricity generators and Ofgem to ensure that the connection of renewable generation to the transmission network can be facilitated quickly and within the current licencing framework.

The price controls contain allowances for transmission reinforcement works to accommodate the growing impact of renewable energy from Scotland. Works to upgrade the circuits connecting Scotland and England are under way and due for completion in 2010 at a cost of around £110 million. Further works are being carried out to increase the capacity of the transmission system in northern England so that increased transfers from Scotland can be transported to demand centres in England and Wales. The further works will be completed in 2011 at a cost of around £230 million.

Network access is being sought by approximately 9 GW of renewable generation projects in Scotland consisting of just over 100 projects, each with connection agreements with National Grid. For England and Wales, connection offers have been made to an additional 8 GW of renewable generation projects.

NGET continues to work closely with the Scottish transmission companies to find innovative solutions to advancing new generation projects in Scotland. Measures have been introduced to allow generators who are ready and able to connect to do so before wider reinforcement works. On 19 March 2009 Ofgem confirmed that they will agree derogations from GB Security and Quality Standards of Supply to advance 450 MW of Scottish renewable generation.

A strategic plan for NGET's networks up to 2050 continues to be developed, recognising the unique role they play in meeting the UK's climate change objectives. In respect of electricity transmission, the plan is aligned with meeting the UK's 2020 renewables target and remaining on the trajectory towards the 2050 greenhouse gas reduction target. Comprising £4.7 billion of mainly onshore strategic infrastructure investment, this plan has been shared with and is supported by the multi-agency Electricity Networks Strategy Group. It facilitates the connection of 34 GW of new renewable wind generation. These new connections will occur alongside an unprecedented replacement of the ageing generation fleet.

A network incorporating variable and potentially large and inflexible generators will be challenging to operate. NGET is a leading part of a cross-industry working group considering these issues and is consulting the industry on the future requirements for balancing services.

**Alliances**

Alliance contracts with various contractors have been entered into by the Transmission business in the UK. These contracts establish a framework for contractors to carry out capital investment projects. Under the terms of the agreements supply chain partners share in the risks and rewards, and are jointly responsible with NGET for work delivery.

# External relationships

NGET aims to enhance relationships with all external stakeholders including investors, customers, regulators, governments, suppliers and the communities in which it operates.

## Investor relations

As a subsidiary company of National Grid, NGET participates in communications to both National Grid's equity shareholders and to holders of debt in NGET, supporting National Grid's programme of active communication.

## Customers, regulators and governments

It is important that customers are treated with respect and that communication and interaction is as clear and straightforward as possible. NGET's focus on customer service and operational excellence is also a critical component of the relationship with regulators and governments, underpinning the building of trust with both. This involves being responsive to the needs of regulators for high quality information, complying with rules and regulations, operating in an ethical way and, most importantly, delivering on promises.

NGET continues to work very closely with Ofgem on the renewal of electricity transmission networks, and in expanding those networks to meet new and changing demand.

## Suppliers

NGET's objective is to use the scale and breadth of its activities to get the best value for money from suppliers. NGET continues to work in partnership with suppliers, developing constructive relationships and working together effectively. The focus in these areas has increased, in response to the greater uncertainties from credit market volatility and the global economic downturn. Collectively, all of the areas that have developed or are being worked towards make NGET an attractive company to do business with. They also enhance NGET's ability to drive value from the supply chain and provide an excellent opportunity for suppliers who are aligned to NGET's approach and ambition.

## Community involvement

NGET continues to participate in National Grid's community involvement programmes, details of which can be found in the National Grid plc Annual Report and Accounts 2008/09.

# Business drivers

## Business drivers

NGET's principal activities include the operation of complex electricity transmission networks. There are many factors that influence the financial returns we obtain. The business is highly developed with numerous drivers. The following are considered to be the principal business drivers:

**Price controls**
The prices NGET charges for use of its electricity transmission networks are determined in accordance with regulator approved price controls. The negotiation of these arrangements has a significant impact on revenues.
Their duration is significant in providing stability, allowing NGET to plan ahead and invest with confidence that financial returns will be obtained. The price controls contain incentive and/or penalty arrangements that can affect NGET financially based on performance targets.

**Safety, efficiency and reliability**
NGET's ability to operate safely and reliably is of paramount importance to the company, its employees, contractors, customers, regulators and the communities served. NGET's financial performance is affected by its performance in these areas.
Operating efficiently allows NGET to minimise prices to customers and improve financial performance.

**Customer service**
The quality of the service delivered to customers, and the experiences that they have in dealing with NGET is important as it feeds through to the attitudes of regulators and is also linked to financial performance.

**Capital investment**
Capital investment is a significant driver for organic growth. In NGET's regulated electricity transmission networks, the prices charged include an allowed return for capital investment determined in accordance with the price controls. These provide incentives to enhance the quality and reach of the networks through capital improvements.

**Inflation and deflation**
During periods of inflation, without action to improve efficiency, operating costs increase each year as a result of wage increases and inflation in external costs. In general, revenues also increase each year, although not necessarily at the same rate, depending on regulatory or contractual arrangements. Correspondingly, during periods of deflation revenues can decrease, the timing and extent of which may not be offset by equivalent reductions in operating costs. Consequently, NGET's ability to control costs and improve efficiency is important in order to maintain and increase operating profits.
Price controls and a proportion of NGET's borrowings are linked to retail price inflation.

**Relationships and responsibility**
NGET's reputation is vitally important to us. Delivering sustainable value depends on the trust and confidence of stakeholders and this can only be earned by conducting business in a responsible manner.

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

**Pass-through costs**
NGET is allowed to recover certain 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.

**Interest rates**
The costs of financing NGET's operations are affected by changes in prevailing interest rates, as some of NGET's debt is at floating rates. NGET hedges some of its exposure to interest rates with fixed-rate debt and derivative financial instruments to maintain a proportion of debt at fixed interest rates.

# Vision, strategy and objectives

As described under 'Organisation and structure' on page 3, National Grid's businesses are managed on a global lines of business basis. As a subsidiary company of National Grid plc, therefore, NGET participates in the National Grid vision and strategy. The following section describes National Grid's vision and strategy to the extent that it relates to NGET. Further details and discussion of the strategy and objectives of National Grid can be found in the Annual Report 2008/09.

## Vision

*The vision is the long term aspiration for National Grid – what we want to be in the future.*

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

## Strategy and National Grid objectives

*Our strategy and objectives are a medium term step in the journey towards the vision – what we are doing over the next few years. We will build on our core regulated business base and financial discipline to deliver sustainable growth and superior financial performance.*

Driving improvements in our safety, customer and operational performance

Delivering strong, sustainable regulatory and long-term contracts with good returns

Modernising and extending our networks

Becoming more efficient through transforming our operating model and increasingly aligning our processes

Building trust, transparency and an inclusive and engaged workforce

Developing our talent, leadership skills and capabilities

Positively shaping the energy and climate change agenda with our external stakeholders

## Responsibility

*Our strategy and objectives are underpinned by our commitment to corporate responsibility. We will operate to the highest standards of corporate governance and conduct our business in a lawful and ethical manner.*

## Line of sight

*The vision, strategy and objectives flow down into every employee's annual performance objectives – what we are doing now and how we ensure we achieve our strategy and vision.*

Our strategy and objectives provide the basis for the annual priorities for each line of business and global function.

These annual priorities form the basis of the objectives for the Executive Directors and flow down the organisation into the individual objectives for every manager and employee. Therefore the actions required to deliver the strategy are allocated and aligned with employee responsibilities.

The aim is that every employee is able to trace their objectives through to the strategy and vision.

## Performance indicators

We use a variety of performance measures to monitor progress against our objectives. Some of these indicators are considered to be key performance indicators and are set out below. Details of performance indicators are provided in the Performance summary section on page 8.

| Objective | KPI |
|---|---|
| Delivering superior financial performance | Adjusted operating profit |
| Driving improvements in safety, customer and operational performance | Employee lost time injury frequency rate |
| Delivering strong sustainable regulatory and long-term contracts with good returns | Operational return |
| Modernising and extending our networks | Network reliability measures |
| Building trust, transparency and an inclusive and engaged workforce | Employee engagement index |

# Performance summary and key performance indicators

| Objective | KPI/performance measure | Description and performance | Target |
|---|---|---|---|
| **Delivering superior financial performance** | **Adjusted operating profit** | **Operating profit excluding exceptional items and remeasurements**<br>**2008/09: £717 million**<br>**2007/08: £650 million** | **Year-on-year increase** |
| | Cash generated by continuing operations | Cash generated by continuing operations<br>2008/09: £1,085 million<br>2007/08: £783 million | |
| | Regulatory gearing | Net debt divided by RAV<br>2009: 58%<br>2008: 52% | |
| **Driving improvements in safety, customer and operational performance** | **Employee lost time injury frequency rate** | **Injuries resulting in employees taking time off work per 100,000 hours worked**<br>**2008/09: 0.10**<br>**2007/08: 0.25** | **Zero** |
| | Injuries to the public | 2008/09: 2<br>2007/08: 4 | Zero |
| | Employee sickness absence rate | 2008/09: 1.45%<br>2007/08: 1.38% | Zero work-related absences |
| **Delivering strong sustainable regulatory contracts with good returns** | **Operational return** | **Electricity Transmission operational return**<br><br>**2008/09: 4.7%**<br>**2007/08: 5.2%** | **Achieve or exceed regulatory allowed return over 5 year price control period of 5.05%** |
| **Modernising and extending our transmission networks** | **Network reliability** | **Electricity Transmission network reliability**<br>**2008/09: 99.9999%**<br>**2007/08: 99.9999%** | **99.9999%** |
| | Total capital investment | 2008/09: £864 million<br>2007/08: £800 million | |
| **Building transparency, trust and an inclusive and engaged workforce** | **Employee engagement score** | **Engagement score calculated from responses to employee survey**<br>**Combined gas and electricity transmission business**<br>**2008/09: 82%**<br>**2007/08: 71%** | **Year-on-year increase** |
| **Positively shaping the energy and climate change agenda** | Significant direct environmental incidents | 2008/09: 9<br>2007/08: 3 | Zero |
| | Greenhouse gas emissions | Year-on-year reduction %<br>Reported one year in arrears<br>2007/08: 28% increase<br>2006/07: 12% reduction | Year-on-year reduction |

# Performance against objectives

NGET's performance and the progress made against objectives are described below and on the following pages. This includes commentary on the financial results on pages 14 to 16.

NGET measures the achievement of objectives through the use of qualitative assessments and through the monitoring of quantitative indicators, called key performance indicators (KPIs). In line with NGET's operating objectives, both financial and non-financial KPIs are used. Where relevant, KPIs are used as the primary measures of whether objectives are being achieved. Because of the scale and size of NGET's operations, many other detailed performance measures are used in addition to KPIs. Qualitative assessments are used to judge progress against objectives in areas where numerical measures are less relevant.

During 2008/09, an assessment of NGET's performance measures has been undertaken, which has resulted in a rationalisation of performance indicators, more directly aligning them with objectives.

A new KPI has been introduced this year for employee engagement. This is measured using an employee engagement score derived from the National Grid annual employee survey administered by Sirota, an independent consultancy firm.

## Delivering superior financial performance

NGET aims to increase adjusted operating profit each year.
The key performance measure used is adjusted operating profit.

Adjusted operating profit for 2008/09 was £717 million. Adjusted operating profit excludes exceptional items and remeasurements.

A more detailed analysis of financial performance is provided on page 14.

## Driving improvements in safety, customer and operational performance

NGET aims for operational excellence by performing to the highest standards of safety and by improving customer service.

### Safety

Safety is paramount. The most important goals are to ensure that members of the public are not injured as a direct result of NGET's operations, to deliver a working environment where there are zero work-related injuries and illness, and to improve the health of employees so they are fit for work every day.
A range of indicators are used to measure performance against safety objectives, including members of the public injured as a direct result of operations, employee lost time injury frequency rate, and employee sickness absence rate. The key performance indicator is employee lost time injury frequency rate.

**Employee safety**

The lost time injury frequency rate (LTIFR), expressed as lost time injuries per 100,000 hours worked, is reported as a key measure that can be compared with other companies. This rate takes into account the number of employees and the workload. As well as reporting the LTIFR, the number of lost time injuries is also reported.

During 2008/09, 4 employees sustained injuries that resulted in them taking time off work, compared with 10 in 2007/08 and a target of zero. The LTIFR in 2008/09 was 0.10 compared to 0.25 in 2007/08.

The principal causes of lost time injuries to employees are road traffic collisions, impact injuries, musculoskeletal injuries and slips trips and falls. Behavioural change initiatives have been targeted in these areas to try to improve performance.

**Employee health**

Improving the health and well-being of employees continues to be a major focus for National Grid, which for several years has had a comprehensive Occupational Health Service to deal with work related health issues. National Grid is now extending its approach to look at the health and well-being of its employees in a more holistic way. As well as the obvious benefits to individuals, there are significant business and societal benefits to having a fit and healthy workforce. In January a new Health and Wellbeing Strategy was launched to provide a series of innovative initiatives that engage staff and encourage the restoration and maintenance of an individual's health, function and fitness. An early focus has been cardiovascular risk with screening being offered to all employees over 45.

NGET's sickness absence rate in 2008/09 was 1.45% compared to 1.38% in 2007/08.

**Public safety**

During 2008/09, 2 members of the public were injured as a result of NGET's operations compared with 4 during 2007/08 and a target of zero.

**Contractor safety**

NGET is committed to the safety of its workforce, not only direct employees. There were 36 contractor lost time injuries in 2008/09 compared to 18 in 2007/08 and a target of zero.

**Customer service**

NGET's aim is to support generators in delivering electricity efficiently and effectively. Transmission customer service activities principally relate to facilitating new connections and maintaining existing connections and relationships with the customers who are already connected.

NGET will achieve its objective by enhancing or replacing the systems used, providing employees with the training, empowerment and support they need to deliver, and by improving the quality of internal and customer communications.

## Delivering strong, sustainable regulatory contracts with good regulatory returns

NGET will work with Ofgem and the UK government to develop the changes that are required to address climate change and security of supply in a way that is affordable for consumers and ensures timely delivery. Significant levels of investment over the next few years means that it is vital that NGET optimises its regulatory returns and ensures that it is appropriately compensated for investments.

**Operational return**

NGET's aim is to deliver good financial returns compared to the regulatory allowances within the price controls.
Performance is measured through an operational return metric comparable to the vanilla return defined in the price controls.

Electricity transmission operational return for 2008/09 was 4.7% compared to 5.2% for 2007/08, broadly in line with the regulatory allowance of 5.05% over the 5 year price control period.

## Modernising and extending the networks

Significant capital investment is needed over the next few years to ensure that NGET meets challenges around security of supply, renewable generation targets and maintaining and improving the reliability of the networks.

**Reliability**

NGET's principal operations are critical to the functioning of the UK economy. The reliability of the networks is one of NGET's highest priorities after safety. NGET's aim is to meet or exceed network reliability and availability objectives.
Network reliability percentages are used as the key performance indicator.

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

Network reliability and availability information for Electricity Transmission is summarised below.

| Years ended 31 March | 2009 | 2008 |
|---|---|---|
| Electricity Transmission network reliability (target 99.9999%) | 99.9999% | 99.9999% |
| Electricity Transmission network average annual availability | 94.64% | 95.09% |
| Electricity Transmission system availability at winter peak demand | 97.7% | 98.0% |

The total amount of electricity transmitted in 2008/09 was 296.1 TWh compared to 303.0 TWh in 2007/08. Peak demand in the winter of 2008/09 was 52.9 GW compared to 54.2 TWh in the winter of 2007/08.

**Capital investment**

Capital investment is one of the principal drivers of future growth, as the majority of capital investment made enables an increased financial return to be earned.

The principal measure used to monitor organic investment is capital expenditure, which includes investment in property, plant and equipment as well as in internally generated intangible assets such as software.

NGET's capital investment plans reflect changing energy infrastructure requirements. The capital investment programme takes place within defined regulatory frameworks that permit a return to be earned on allowed investments. Investment in electricity transmission systems is, by its nature, variable and is largely driven by changing sources of supply and asset replacement requirements. The electricity transmission licence also obliges NGET to provide connections and capacity on request.

Capital investment continues to include high levels of expenditure on the replacement of electricity transmission network assets, many of which were commissioned in the 1960s, and also increasing expenditure on load related infrastructure. This, together with work required to meet changing supply sources, means that the electricity transmission business will continue to see a significant increase in investment and network renewal.

Total investment in electricity network assets amounted to £864 million in 2008/09, compared with £800 million in 2007/08. Capital investment included £9 million with respect to intangible assets, principally software applications (2007/08: £15 million).

## Becoming more efficient by transforming the operating model and increasingly aligning processes

NGET's operating model is focused on the delivery of services to customers, developing the sharing of best practice and positioning the business to deliver improvements in operating and financial performance.

NGET's focus during the current year and in the short term is on maximising efficiencies in the operating model within each line of business. Through targeted reductions in the number of processes and through standardisation and simplification NGET aims to maximise efficiencies and reduce cost.

National Grid continues to develop its procurement operating model which is now structured on a strategic spend category basis. This structure drives greater focus in delivering value from the supply chain. The management team has been strengthened as NGET seeks to improve the performance of this part of the business.

**Efficiency**

By improving efficiency the cost of operations borne by customers can be constrained and returns improved. Operations are reviewed continually to identify opportunities to improve the operational productivity of NGET's assets and employees and to identify areas in which costs can be reduced or cost increases restricted.

Much of the focus for Electricity Transmission has been on preparing for the significant increase in capital investment that will occur in future years, including developing the strategic investment plan.

## Building trust, transparency and an inclusive and engaged workforce

In order to maximise the potential of NGET's workforce to achieve its objectives it is important to develop belief and engagement in National Grid's vision.

**Engagement and performance**

To succeed NGET needs to engage its employees to strive for continuous improvement. The aim is to implement a world-class performance management process.
The key performance indicator is the employee engagement index based on the independent annual employee survey

NGET's approach involves adopting National Grid integrated common performance processes and a single set of performance criteria with pay linked to leadership qualities as well as operational and financial performance, providing for clearer differentiation between levels of performance.

**Employee engagement**

In February 2009, National Grid conducted its second annual employee engagement survey. A total of 24,727 employees, representing 91.8% of the total workforce, took part, a 5.5% increase in the response rate compared to 2008. During 2008, intensive action planning was undertaken at National Grid, line of business and individual level to address the key themes of improving communications, providing greater clarity on vision and direction and providing stronger links between performance and reward.

The 2009 survey reported a 10% increase in employee engagement within National Grid as a whole. Improvements were reported across all survey dimensions, with significant improvements in the areas of vision, direction and communications which were key action items from the 2008 survey.

Within NGET the engagement score for the principal line of business, Transmission, is monitored. In 2008/09, Transmission employee engagement in the UK was 82% compared to 71% in 2007/08.

**Performance management**

National Grid continues the task of building a high performance culture and, further to the work with senior managers, training has now been completed for the majority of middle and first line managers on 'Performance for Growth', National Grid's global performance management system. The process continues to focus on raising the performance bar and supporting high quality conversations. 'Support and challenge' groups have been established, which continue to review best practice, share knowledge and enable managers to have a peer support network.

These performance programmes are driving stronger personal accountability, and the leadership within National Grid is now actively involved in creating a culture where everyone across the business understands that business results are of primary importance, and that they can directly influence this.

**Inclusion and diversity**

In order to develop, recruit and retain talented people, National Grid aims to achieve a more inclusive and diverse workforce, reflecting the composition of the communities in which it operates, and to be seen as an employer of choice across diverse communities.

Performance measures used to monitor the objective of promoting inclusion and diversity include the percentage of female employees and the percentage of ethnic minority employees.

Following a thorough review of policies throughout National Grid, the commitment to inclusion and diversity has been reaffirmed by highlighting its importance to employee engagement and productivity, the recruitment and retention of talent, and external reputation within the inclusion business case.

During the year National Grid launched its global Inclusion Charter. The charter explains what employees can expect from the Company, as well as what National Grid expects from employees and builds on work in progress throughout the business.

In addition, an inclusion and diversity transition group has been established to develop the necessary communications, governance and human resource processes to support our efforts. Training has continued to offer greater awareness of inclusive behaviours and we have recently launched a new inclusive leadership learning programme.

At 31 March 2009, 13.5% of NGET's employees were female and 9.5% were from ethnic minority groups, compared to 15.3% and 9.0% at 31 March 2008.

Across all of National Grid's operations in the UK, as at 31 March 2009 22.1% of employees were female and 7.5% from ethnic minority groups, compared to 22.5% and 6.5% at 31 March 2008. Of all new hires in National Grid's UK operations in 2008/09, 36.7% were female and 13.1% were from ethnic minority groups.

NGET aims to maximise the contribution of its 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.

## Developing talent, leadership skills and capabilities

Identifying, recruiting and developing talented people is critical to NGET's future success.

NGET aims to support all its 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.

National Grid has strengthened its talent management processes in 2008/09, creating talent management plans for senior management and for business critical roles. It is now conducting regular cross-business talent planning sessions using consistent processes to support senior management in developing employees within each business area and to address succession issues.

National Grid's focus on developing the talent of current and future business leaders has moved forward with the launch of the developing future leaders programme for senior managers. National Grid has also launched a foundations of leadership programme for first line leaders and supervisors and a future leaders programme with a focus on enhancing business acumen and the demonstration of leadership qualities.

NGET continues to invest in the recruitment and development of skilled employees for the future, jointly with National Grid's other UK businesses, recruiting 184 advanced apprentices, 58 foundation engineers and 30 graduates across the UK. These programmes are designed to facilitate the entrance, training and progression of talented people into National Grid, with special emphasis on key engineering roles.

## Positively shaping the energy and climate change agenda with external stakeholders

National Grid's aim is to embrace, address and lead on the current and future issues affecting the energy market. It is committed to safeguarding the global environment for future generations, taking positive action to reduce its contribution to climate change and other impacts on the environment. National Grid strives to be an environmental leader and will work with regulators to develop the regulatory framework required to address the changes in future energy supplies.

This year has seen significant changes to UK government policy with the introduction of the Climate Change and Energy Acts, which will implement a wide range of measures including setting carbon budgets on a national scale and enshrining climate change targets in law.

**Positively shaping the agenda**

National Grid aims to take the lead on the energy and climate change issues facing society, not simply reacting to the initiatives of other relevant bodies but instead, being proactive in leading the agenda to help safeguard the environment.

National Grid's performance measure in this area is the qualitative monitoring of its contribution to various projects, committees, task forces and other initiatives aimed at addressing these issues.

**Climate change**

National Grid continues with its climate change initiatives and energy efficiency programmes, focusing on initiatives that are cost effective and regulated.

The National Grid key performance indicator to monitor performance in this area is the percentage reduction in greenhouse gas emissions against baseline.

As reported last year, National Grid has adopted a long-term target of reducing Scope 1 and 2 greenhouse gas emissions by 80% against baseline by 2050. An intermediate objective has now been set of a 45% reduction in emissions by 2020. These targets remain at the centre of efforts to identify and implement measures to meet National Grid's commitment to safeguard the global environment for future generations. In 2009/10, the inclusion of Scope 3 emissions into these targets will be evaluated.

This year, efforts have been focused on educating the workforce on the targets and the means by which they will be achieved. An inventory of greenhouse gas emissions has been conducted across National Grid to ensure that there is up-to-date information on the magnitude of the reductions necessary, and the areas of operations where reductions can take place. Internal working teams have been established, tasked with developing opportunities to achieve the 80% target.

This climate change initiative is being embedded in all areas and operations of National Grid through the establishment of teams working in such areas as introducing low emission vehicles, developing low carbon design features for asset replacement programmes and incorporating a 'cost of carbon' methodology in investment decision making processes.

During 2009/10, carbon budgets will be implemented within National Grid. For each financial year, each business within National Grid will be set a maximum level of greenhouse gas emissions which can be emitted. Subsequent years will see a reduction in these budgets that is needed to achieve the 2020 and 2050 targets.

Performance on greenhouse gas emissions against target are reported for National Grid as a whole in the National Grid plc

Annual Report and Accounts 2008/09. For NGET, year on year reductions are currently reported.

The 2008/09 data is not currently available. It is expected to become available in July 2009 at which point the data for National Grid as a whole will be presented on the National Grid website. Data for NGET will be presented in next years' Annual Report and Accounts, and in future periods, the year-on-year performance will continue to lag by one year.

**Protecting the environment**
National Grid is committed to helping to protect the environment for future generations and to continuously improving environmental performance.

All of NGET's employees work to environmental management systems certified to the international standard ISO 14001.

The performance indicators that are monitored in this area include the number of significant direct environmental incidents.

The number of significant environmental incidents in 2008/09 arising directly from NGET's operations was 9, which includes 3 contractor-related incidents. In 2007/08, there were 3 incidents, none of which were contractor-related incidents. There were no prosecutions by enforcing bodies resulting from these incidents.

NGET takes seriously the issues that surround electric and magnetic fields, recognising that there is scientific uncertainty as to whether the electric and magnetic fields that are produced by some of its assets have an effect on health or not, and that this produces public concern. NGET monitors the science carefully (this year has seen new studies on issues such as Alzheimer's disease and damage to genes) but looks to relevant independent bodies such as the World Health Organization and the UK's Health Protection Agency for authoritative advice. In all of NGET's operations, as a minimum, it aims to comply with the relevant regulations, guidelines or practices in force. In addition, it actively supports high-quality research and open communication (including maintaining a website at www.emfs.info) and looks for more constructive and less confrontational ways of handling this issue. All these activities are governed by National Grid's public position statement on electric and magnetic fields, which is reviewed annually.

National Grid's website (www.nationalgrid.com), provides further information on the steps being taken to reduce its impact on the environment, including use of natural resources and minimising the impact on the environment of waste.

**Responsibility**
NGET believes operating responsibly is essential to the way it conducts its operations, invests in its business, develops its people and manages its relationships. It underpins everything done by NGET and is a prerequisite to its contribution to delivering National Grid's vision.

NGET always strives to operate to the highest standards of corporate governance and believes in strong business ethics, based around National Grid's Framework for Responsible Business and its 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 Framework defines the principles by which NGET manages its business and its day-to-day dealings with customers, employees, shareholders, suppliers and local communities. It is underpinned by Company wide policies and position statements that are available on the National Grid website.

More information on National Grid's approach to corporate responsibility and business ethics is included in the Corporate Governance section of the National Grid plc Annual Report and Accounts 2008/09.

# Risks and opportunities

**Risks and opportunities**
It is believed that the principal opportunities NGET has 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 NGET's objectives.

Conversely, NGET risks a shortfall in this contribution if it does not fulfil National Grid's strategy or if it fails to achieve its objectives.

*Financial performance*
Financial performance and operating cash flows are the basis for funding NGET's future capital investment programmes, for servicing its borrowings and paying dividends.

*Responsibility*
Strong corporate governance is essential to operating responsibly and the achievement of all NGET's objectives. NGET's reputation as a responsible business depends on all its behaviours being lawful and ethical, on complying with its policies and licences and on living up to its core values. If NGET does not live up to these high standards it could be exposed to adverse financial or other consequences.

*Driving improvements in safety, customer and operational performance*
The operating profits and cash flows generated by NGET are dependent on its operating performance – operating safely, reliably, and providing a quality service to customers.

*Delivering strong, sustainable regulatory contracts with good returns*
NGET's relationships with stakeholders are critical to its future success. Maintaining these good relationships is dependent on focusing on the areas that are important to them, such as the quality of service provided to customers, the quality of information provided to regulators and the way NGET addresses the concerns of, and interacts with, all its stakeholders.

*Modernising and extending the transmission network*
NGET's future organic growth is dependent on the delivery of its capital investment plans. In order to deliver sustainable growth with a superior financial performance NGET will need to finance its investment plans. Instability in the financial markets may restrict NGET's ability to raise finance.

*Becoming more efficient through transforming the operating model and increasingly aligning processes*
Transforming the way NGET operates through the simplification and standardisation of systems and process will drive efficiency and reduce costs. Conversely, if NGET does not achieve this transformation, or associated benefits in efficiency, reductions of costs will not be achieved.

*Building trust, transparency and an inclusive and engaged workforce*
NGET's workforce is a vital part of its business and is critical to its future success. Failure to maintain a trusting, engaged, and motivated workforce, who can see how their actions directly contribute to achieving NGET's strategy and objectives, will restrict NGET's ability to meet those objectives.

*Developing talent, leadership skills and capabilities*
The skills and talents of NGET's employees, and their motivation and dedication, are critical to the achievement of its objectives. Failure to develop existing employees or to attract and recruit talented new employees could hamper NGET's ability to deliver in the future.

*Positively shaping the energy and climate change agenda*
Safeguarding the global environment for future generations is dependent on integrating sustainability and climate change considerations into NGET's business decisions, influencing legislators and regulators to reshape energy markets to meet the climate change challenge, and helping and supporting employees, customers and suppliers in changing their behaviour to be more environmentally aware.

How NGET intends to achieve these objectives and the progress made during the year is set out on on pages 8 to 13.

**Risk management**
The approach of NGET to risk management is described in the principal risks and uncertainties section of this Operating and Financial Review below. In addition, information on how certain financial risks have been addressed is included in the financial position and financial management section of this Operating and Financial Review on pages 17 to 22.

**Risk factors**
The following significant risks and uncertainties in achieving NGET's objectives have been identified:

- 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
- reputation damage from disruptions to supply, even if outside NGET's control
- fluctuations in interest rates and their impact on borrowings and derivatives
- restrictions in borrowings, changes in credit ratings, volatility and disruption of global financial markets and reduced liquidity and access to funding opportunities
- periods of deflation
- future funding requirements of pension schemes
- changes in accounting standards or in tax rates
- consumers, suppliers or other counterparties failing to perform their obligations

Not all of these factors are within NGET's control and, in addition, there may be other factors besides those listed that may have an adverse effect on NGET.

# Financial performance

Performance against KPIs is described on pages 8 to 13. In the following section a more detailed analysis of the financial results.

NGET's financial results and position are reported in accordance with International Financial Reporting Standards (IFRS).

**Measurement of financial performance and use of adjusted profit measures**
In considering the financial performance of the Transmission business, each of the primary financial measures of operating profit, profit before tax and profit for the year are analysed 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 reported financial performance from year to year.

Measures of business performance are referred to in these accounting statements 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 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 the business has no control.

Adjusted profit measures are limited in their usefulness compared with the comparable total profit measures, as they exclude important elements of underlying financial performance, namely exceptional items and remeasurements. Management 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 overall financial performance.

**Profit for the year from continuing operations**

*Adjusted earnings*

| | Years ended 31 March | |
|---|---|---|
| Transmission business | **2009** | 2008 |
| | **£m** | £m |
| Adjusted operating profit | **717** | 650 |
| Net finance costs excluding exceptional items and remeasurements | **(186)** | (171) |
| Adjusted profit before taxation | **531** | 479 |
| Taxation excluding taxation on exceptional items and remeasurements | **(149)** | (140) |
| Adjusted profit from continuing operations | **382** | 339 |

*Earnings*

| | Years ended 31 March | |
|---|---|---|
| Transmission business | **2009** | 2008 |
| | **£m** | £m |
| Total operating profit | **708** | 645 |
| Net finance costs | **(218)** | (166) |
| Profit before taxation | **490** | 479 |
| Taxation | **(153)** | (93) |
| Profit from continuing operations | **337** | 386 |

*Net finance costs*

Net interest excluding exceptional finance costs and remeasurements increased by £15 million from 2007/08 to 2008/09. This was primarily explained by an increase in average debt balances.

Financial remeasurements relate to net losses on derivative financial instruments of £32 million in 2008/09, compared with net gains of £5 million in 2007/08.

*Taxation*

The net tax charge of £153 million in 2008/09 comprised a £149 million charge on adjusted profit before tax and a £4 million charge on exceptional items and remeasurements. This compares with a net charge of £93 million in 2007/08, comprising a £140 million charge on adjusted profit before tax and a £47 million credit on exceptional items and remeasurements. The 2007/08 net charge included an exceptional credit of £47 million 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 took effect from 1 April 2008.

The effective tax rate before and after exceptional items and remeasurements was 28.1% and 31.2% respectively (2007/08: 29.2% and 19.4%), compared with a standard UK corporation tax rate of 28% in 2008/09 and 30% in 2007/08.

**Profit for the year from continuing operations**

Profit for the year from continuing operations decreased from £386 million in 2007/08 to £337 million in 2008/09 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 | |
|---|---|---|
| Transmission business | **2009** | 2008 |
| | **£m** | £m |
| Adjusted operating profit | **717** | 650 |
| Exceptional items | **(9)** | (5) |
| Total operating profit | **708** | 645 |

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 | |
|---|---|---|
| Transmission business | **2009** | 2008 |
| | **£m** | £m |
| Adjusted profit before taxation | **531** | 479 |
| Exceptional items | **(9)** | (5) |
| Derivative financial remeasurements | **(32)** | 5 |
| Total profit before taxation | **490** | 479 |

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 | |
|---|---|---|
| Transmission business | **2009** | 2008 |
| | **£m** | £m |
| Adjusted earnings | **382** | 339 |
| Exceptional items | **(22)** | 44 |
| Derivative financial remeasurements | **(23)** | 3 |
| Earnings | **337** | 386 |

Adjusted earnings is presented on the face of the consolidated income statement, under the heading ‘Profit after taxation – before exceptional items and remeasurements’.

**Operating profit**

Operating profit for 2008/09 and 2007/08 was as follows:

| | Years ended 31 March | |
|---|---|---|
| Transmission business | **2009** | 2008 |
| | **£m** | £m |
| Revenue | **2,556** | 2,106 |
| Operating costs | **(1,848)** | (1,461) |
| Total operating profit | **708** | 645 |
| Comprising: | | |
| Adjusted operating profit | **717** | 650 |
| Exceptional items | **(9)** | (5) |
| Total operating profit | **708** | 645 |

The principal movements in Transmission business operating profit between 2007/08 and 2008/09 can be summarised as follows:

| Transmission business | Revenue | Operating costs | Operating profit |
|---|---|---|---|
| | £m | £m | £m |
| 2007/08 operating profit | 2,106 | (1,461) | 645 |
| Add back 2007/08 exceptional items | - | 5 | 5 |
| 2007/08 adjusted operating profit | 2,106 | (1,456) | 650 |
| Allowed revenues | 124 | - | 124 |
| Timing of recoveries | 18 | - | 18 |
| BSIS | 318 | (330) | (12) |
| Depreciation and amortisation | - | 21 | 21 |
| Other | (10) | (74) | (84) |
| 2008/09 adjusted operating profit | 2,556 | (1,839) | 717 |
| 2008/09 exceptional items | - | (9) | (9) |
| 2008/09 operating profit | 2,556 | (1,848) | 708 |

Revenue increased by £450 million to £2,556 million in 2008/09 compared to £2,106 million in 2007/08. This related to recovery of higher incentivised costs associated with balancing the system (BSIS) and an increase in allowed revenues, together with the impact of timing on recoveries.

Operating costs, excluding exceptional items, increased by £383 million to £1,839 million in 2008/09 compared to £1,456 million in 2007/08. This was primarily due to higher BSIS incentivised costs, mainly recovered by the revenue increase above, and higher pass-through costs also recovered in revenue.

Exceptional items of £9 million in 2008/09 and £5 million in 2007/08 comprise restructuring costs arising from planned cost reduction programmes.

Total operating profit increased by £63 million to £708 million in 2008/09 compared to £645 million in 2007/08, due to the £67 million increase in adjusted operating profit and a £4 million increase in exceptional charges.

**Cash flows**

*Cash flows from operating activities*

Cash generated from operations was £1,085 million in 2008/09 compared with £783 million in 2007/08. This included cash outflows relating to exceptional items of £5 million in 2008/09 and £5 million in 2007/08.

There was a net corporate tax payment in 2008/09 of £189 million compared with a receipt of £24 million in 2007/08.

After reflecting cash flows relating to taxation, the net cash inflow from operating activities was £896 million in 2008/09, compared with £807 million in 2007/08.

*Cash flows from investing activities*

Cash outflow from investing activities was £271 million in 2008/09 compared to £1,178 million in 2007/08. Cash outflows to purchase property, plant and equipment and intangible fixed assets, net of disposal proceeds, were £857 million in 2008/09 compared to £717 million in 2007/08, as a result of the increase in capital investment. Interest received was £30 million in 2008/09 compared to £55 million in 2007/08. Net cash inflows from sale of financial investments were £556 million in 2008/09 compared to outflows on purchase of financial investments of £516 million in 2007/08.

*Cash flows from financing activities*

The net cash outflow from financing activities was £16 million in 2008/09 compared to an inflow of £221 million in 2007/08. Net inflows from loans were £200 million (2007/08: £408 million). Net interest cash outflows increased from £132 million in 2007/08 to £154 million in 2008/09 due mainly to higher average net debt.

# Financial position and financial management

## Going concern

Having made enquiries, the Directors consider that NGET 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. More details on NGET's liquidity position are provided under the heading Liquidity and treasury management below and in note 24 to the consolidated financial statements.

## Financial position

**Balance sheet**

The balance sheet at 31 March 2009 can be summarised as follows:

| | Assets £m | Liabilities £m | Net assets £m |
|---|---|---|---|
| Property, plant and equipment and non-current intangible assets | 6,030 | - | 6,030 |
| Current assets and liabilities | 181 | (556) | (375) |
| Other non-current assets and liabilities | - | (220) | (220) |
| Pension obligations | - | (403) | (403) |
| Deferred tax | - | (711) | (711) |
| Total before net debt | 6,211 | (1,890) | 4,321 |
| Net debt | 915 | (4,791) | (3,876) |
| Total as at 31 March 2009 | 7,126 | (6,681) | 445 |
| Total as at 31 March 2008 | 6,756 | (6,299) | 457 |

The £12 million decrease in net assets from £457 million at 31 March 2008 to £445 million at 31 March 2009 resulted from the profit for the year from continuing operations of £337 million, net expense recognised directly in equity of £79 million and transfers of £270 million. Transfers represent the reallocation of funding balances between the regulated Transmission business and other activities of NGET, principally arising from dividend payments made by the company.

**Net debt**

Net debt increased by £540 million from £3,336 million at 31 March 2008 to £3,876 million at 31 March 2009. Cash flows from operations net of tax of £896 million were offset by capital expenditure, net of adjustments on disposal, of £857 million, net funding transfers arising from dividends paid by NGET of £270 million and net interest paid £154 million, together with fair value and other adjustments of £155 million.

At 31 March 2009, net debt comprised borrowings of £4,712 million including bank overdrafts of £4 million, less financial investments of £360 million, derivative financial instruments with a net carrying value of £89 million and cash and cash equivalents of £387 million. At 31 March 2008, net debt comprised borrowings of £4,301 million, less derivative financial instruments of £42 million, financial investments of £914 million and cash and equivalents of £9 million.

The maturity of borrowings is shown in note 13 to the consolidated financial statements.

**Capital structure**

NGET monitors the regulatory asset value (RAV) gearing of the Electricity Transmission business. This is calculated as net debt expressed as a percentage of RAV, and indicates the level of debt employed to fund the regulated business. It is compared to the level of RAV gearing indicated by Ofgem as being appropriate for regulated businesses, at around 60%.

This is considered this to be a more appropriate measure than the standard gearing ratio using the accounting value of net assets as it better reflects the economic value of NGET's assets.

RAV gearing as at 31 March 2009 was 58% (estimated), compared to 52% as at 31 March 2008 (actual).

## Liquidity and treasury management

**Treasury policy**

Funding and treasury risk management for NGET is carried out by the Treasury function of National Grid under policies and guidelines approved by the Finance Committees of the Boards of National Grid plc and National Grid Electricity Transmission plc. The Finance Committees have authority delegated from the relevant Boards and are responsible for regular review and monitoring of treasury activity and for approval of specific transactions, the authority for which may be delegated.

The primary objective of the Treasury function is to manage the funding and liquidity requirements of National Grid. A secondary objective is to manage the associated financial risks (in the form of interest rate risk and foreign exchange risk) to within acceptable boundaries. Further details of the management of funding and liquidity and the main risks arising from financing activities are set out below, as are the policies for managing these risks including the use of financial derivatives, which are agreed and reviewed by the Boards and the Finance Committees.

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.

**Current condition of the financial markets**

During 2008/09 there has been a deterioration in the world economic situation. In particular, there has been a crisis in the banking system, the failure or near failure of individual banks and increased restrictions on lending across capital and money markets. This has been accompanied by a significant widening in credit spreads. However, with its low risk business model and cash flows that are largely stable over a period of years, NGET has been able to continue to access the markets and during 2008/09 has issued £1,001 million of external long-term debt. NGET remains confident of its ability to access the public debt markets going forward.

**Cash flow and cash flow forecasting**
Cash flows from operations are largely stable annually and over a period of years, although they do depend on the timing of customer payments. NGET's transmission operations are subject to multi-year price control agreements with the regulator, Ofgem.

NGET's capital investment programme is financed through a combination of internal cash flows and borrowings. Both short and long-term cash flow forecasts are produced regularly to assist in identifying short-term liquidity and long-term funding requirements and a project is being undertaken to enhance the cash flow forecasting processes. Cash flow forecasts, supplemented by a financial headroom position, are supplied to the Finance Committee to assess funding adequacy for at least a 12 month period.

**Regulatory restrictions**
As part of NGET's regulatory arrangements, its operations are subject to a number of restrictions on the way it can operate. These include a regulatory 'ring-fence' that requires NGET to maintain adequate financial resources and restricts the ability to make dividend payments, lend cash or levy charges between NGET and fellow subsidiary companies of National Grid.

**Funding and liquidity management**
NGET maintains medium term note and commercial paper programmes to facilitate long and short-term debt issuance into capital and money markets.

At 31 March 2009, NGET had a $1.0 billion US commercial paper programme (unutilised) and a $1.0 billion Euro commercial paper programme (unutilised). It also has a joint €15 billion Euro medium term note programme with National Grid plc (€9.3 billion issued).

In addition, NGET has both committed and uncommitted bank borrowing facilities that are available for general corporate purposes. At 31 March 2009, it had £425 million of long term committed facilities (undrawn).

Surplus funds are invested on the money markets, usually in the form of short-term fixed deposits and placements with money market funds that are invested in highly liquid instruments of high credit quality. Investment of surplus funds is subject to NGET's counterparty risk management policy, and NGET continues to believe that its cash management and counterparty risk management policies provide appropriate liquidity and credit risk management in light of the current crisis in the financial markets. Details relating to cash, short-term investments and other financial assets at 31 March 2009 are shown in notes 11 and 12 to the consolidated financial statements.

Management believes that maturing amounts in respect of contractual obligations as shown in Commitments and contingencies in note 20 to the consolidated financial statements can be met from existing cash and investments, operating cash flows and other financings that NGET reasonably expects to be able to secure in the future, together with the use of committed facilities if required.

**Credit ratings**
It is a condition of the regulatory ring-fence around the NGET that it uses reasonable endeavours to maintain an investment grade credit rating. As of 31 March 2009, 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 |

Moody's changed the outlook of their rating from negative to stable on 20th July 2009. This means that the ratings now have a stable outlook with all three rating agencies.

**Use of financial derivatives**
As part of NGET's business operations, including its treasury activities, it is exposed to risks arising from fluctuations in interest rates and exchange rates. NGET uses financial instruments, including financial derivatives, to manage exposures of this type. NGET's policy is not to use financial derivatives for trading purposes. Derivative positions are managed in a non speculative manner, such that all transactions in financial derivatives are matched to an underlying current or anticipated business requirement. More details on derivative financial instruments are provided in note 8 to the consolidated financial statements.

**Refinancing risk management**
Refinancing risk within National Grid is controlled mainly by limiting the amount of debt maturities (both principal and interest) arising on borrowings in any financial year.

Note 13 to the consolidated financial statements sets out the contractual maturities of NGET's borrowings over the next five years, with total contracted borrowings maturing over 50 years. NGET expects to be able to refinance this debt through the capital and money markets as has been done during 2008/09.

**Interest rate risk management**
NGET's 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. The interest rate risk management policy followed by National Grid 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 an extreme movement in interest rates, neither the interest cost nor the total financing cost is expected to exceed pre-set limits with a high degree of certainty.

Within these constraints, the interest rate risk of National Grid is actively managed, with over 50% of debt exposed to floating or index-linked interest rates in the longer term. In 2009/10 the financing costs of National Grid are expected to benefit from lower interest rates, some of which have already been locked in using short-term interest rate derivatives, and inflation.

Some of NGET's bonds in issue are index-linked, that is their cost is linked to changes in the UK Retail Prices Index (RPI).

Management believes that these bonds provide a good hedge for revenues and regulatory asset values that are also RPI-linked under NGET's price control formulas.

The performance of the Treasury function in interest rate risk management is measured by comparing the actual total financing costs of the National Grid debt with those of a passively-managed benchmark portfolio with a constant ratio of fixed rate to floating rate debt, to identify the impact of actively managing National Grid's interest rate risk. This is monitored regularly by the Finance Committee of National Grid.

More information on the interest rate profile of debt is included in note 24 to the consolidated financial statements.

**Foreign exchange risk management**
NGET has 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, NGET is exposed to currency exposures on borrowings in currencies other than sterling, principally the euro. This currency exposure is managed through the use of cross-currency swaps, so that post derivatives the currency profile is almost entirely sterling.

The currency compositions of financial liabilities and assets are shown in note 24(a) to the consolidated financial statements.

**Counterparty risk management**
Counterparty risk arises within the National Grid Treasury function from the investment of surplus funds and from the use of derivative instruments, and outside the Treasury function from commercial contracts entered into by the businesses, including commodity contracts. The National Grid Finance Committee has agreed a policy for managing such risk. This policy sets limits as to the exposure that National Grid can have with any one counterparty, based on that counterparty's credit rating from independent rating agencies. National Grid's exposure to individual counterparties is monitored on a frequent basis and counterparty limits are regularly updated for changes in credit ratings. The Treasury function is responsible for managing the policy. Where contracts are entered into outside the Treasury function, part of the relevant counterparty limit can be allocated to the business area involved. This ensures that National Grid's overall exposure is managed within the appropriate limit.

Further information is provided in note 24(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 the exposure to credit risk of that counterparty. At the present time, standard International Swap Dealers Association (ISDA) documentation is used, 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.

**Valuation and sensitivity analysis**
NGET calculates the fair value of debt and financial derivatives by discounting all future cash flows by the market yield curve at the balance sheet date and in the case of financial derivatives taking into account the credit quality of both parties. 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.

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

As described in note 24(d) to the consolidated financial statements, movements in financial indices would have the following estimated impact on the financial statements as a consequence of changes in the value of financial instruments.

| Years ended 31 March | 2009 | | 2008 | |
|---|---|---|---|---|
| | Income statement £m | Other equity reserves £m | Income statement £m | Other equity reserves £m |
| UK Retail Prices Index ± 0.50% | 7 | - | 6 | - |
| UK interest rates ± 0.50% | 3 | 18 | 1 | 9 |

**Commodity contracts**
NGET has entered into electricity contracts, pursuant to the requirement to stabilise the electricity market in Great Britain through the operation of the British Electricity Trading and Transmission Arrangements (BETTA). These contracts are for varying terms and have been entered into so that NGET has the ability to deliver electricity as required to meet its obligations under its electricity transmission licence. NGET has not and does not expect to enter into any significant derivatives in connection with its BETTA role.

## Commitments and contingencies

Commitments and contingencies outstanding at 31 March 2009 and 2008 are summarised in the table below:

| | **2009 £m** | 2008 £m |
|---|---|---|
| Future capital expenditure contracted but not provided for | **763** | 482 |
| Total operating lease commitments | **63** | 66 |
| Other commitments and contingencies | **40** | 19 |

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

NGET proposes to meet all of its commitments from existing cash and investments, operating cash flows, existing credit facilities, future facilities and other financing that its reasonably expects to be able to secure in the future.

**Details of material litigation as at 31 March 2009**
NGET was not party to litigation that was considered to be material as at 31 March 2009.

## Related party transactions

NGET provides services to and receives services from related parties, principally fellow subsidiaries of National Grid. In the year ended 31 March 2009, NGET charged £41 million and received charges of £59 million from related parties (other than Directors and key managers), compared with £41 million and £55 million respectively in 2007/08.

Further information relating to related party transactions is contained within note 21 to the consolidated financial statements. Details of key management compensation are included within note 1(c).

## Retirement arrangements

The substantial majority of NGETs' employees are members of the National Grid Electricity Group of the Electricity Supply Pension Scheme. This scheme is a defined benefit scheme and is closed to new members. New employees are offered membership of the defined contribution section of the National Grid UK Pension Scheme, which is operated by Lattice Group plc, a fellow subsidiary company of National Grid. NGET does not provide any other post-retirement benefits.

**Net pension obligations**
The following table summarises the pension obligations relating to the Tranmssion business as recorded in the consolidated regulatory financial statements:

| | £m |
|---|---|
| As at 1 April 2008 | (403) |
| Pension service cost | (12) |
| Interest less expected return | (19) |
| Curtailments and settlements | (2) |
| Actuarial gains and losses | |
| – on plan assets | (298) |
| – on plan liabilities | 221 |
| Contributions: | |
| – ordinary contributions | 21 |
| – additional contributions | 89 |
| **As at 31 March 2009** | **(403)** |

| | |
|---|---|
| Plan assets | 1,130 |
| Plan liabilities | (1,533) |
| Net plan liability | (403) |

The amounts recorded in the balance sheet are based on accounting standards which require pension obligations to be calculated on a different basis from that used by the actuaries to determine the funding needed to make into the plan.

The principal movements in net pension obligations during the year arose as a consequence of actuarial gains on plan liabilities, principally as a consequence of using higher discount rates to calculate the present value of these obligations. This was partially offset by actuarial losses on the value of plan assets.

**Actuarial position**
The last completed full actuarial valuation of the National Grid section of the Electricity Supply Pension Scheme was as at 31 March 2007. This concluded that the pre-tax funding deficit was £405 million on the basis of the funding assumptions. Employer cash contributions for the ongoing cost of this plan are currently being made at a rate of 20.5% of pensionable payroll, with administration fees paid in addition.

**Contributions**
In addition to ongoing employer contributions NGET made deficit contributions of £90 million during 2008/09 and £90 million in April 2009. The remaining deficit will be payable monthly from April 2012 to March 2017.

The next valuation of the scheme is due as at 31 March 2010.

**Plan assets**
The National Grid Electricity Group of the Electricity Supply Pension Scheme is trustee administered and the trustees are responsible for setting the investment strategy and monitoring investment performance, consulting with us where appropriate.

At 31 March 2009 plan assets totalled £ 1,145 million (2008: £1,321 million) invested as follows:

| | % |
|---|---|
| Equities | 47.6 |
| Corporate bonds | 13.0 |
| Gilts | 33.0 |
| Property | 4.8 |
| Other | 1.6 |

# Accounting policies

## Basis of accounting

The consolidated financial statements present the results for the years ended 31 March 2009 and 2008 for the regulated Transmission business. They have been prepared using the accounting policies shown, in accordance with International Financial Reporting Standards (IFRS).

In complying with IFRS, the Transmission business is 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, the consolidated financial statements have been presented in accordance with IFRS. A number of choices were required to be made on the adoption of IFRS and in addition it is necessary to 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**
The opening IFRS balance sheet was established as at 1 April 2004. Certain balances in the previous UK GAAP financial statements were used as the basis for the opening IFRS balance sheet.

**Business combinations**
Business combinations prior to 1 April 2004 were not changed retrospectively.

**Carrying value of assets at transition**
Brought forward depreciated cost, as adjusted for changes in accounting policies to conform to IFRS, was used to be the opening carrying value under IFRS.

**Share-based payments**
All active share option grants were recognised retrospectively.

**Cumulative translation differences**
A choice was made to measure and present cumulative translation differences arising since 1 April 2004 only.

Significant choices that continue to be made on an ongoing basis include the following:

**Presentation formats**
The nature of expense method is used for the income statement and the balance sheet is totalled to net assets and total equity.

In the income statement, subtotals of total operating profit, profit before tax and profit from continuing operations are presented, together with additional subtotals excluding exceptional items and remeasurements. Exceptional items and remeasurements are presented on the face of the income statement.

**Pensions**
Actuarial gains and losses are recognised each year in the statement of recognised income and expense.

**Capitalised interest**
Interest is capitalised into the cost of assets constructed, 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**
Hedge accounting is normally opted to be applied in most circumstances where this is permitted.

**Accounting standards and interpretations adopted in 2008/09**

In preparing the consolidated financial statements NGET has complied with International Financial Reporting Standards, International Accounting Standards and interpretations applicable for 2008/09. The following amendments to standards and interpretations were adopted during 2008/09, none of which resulted in a material change to our consolidated results, assets or liabilities in 2008/09 or in those of previous periods*:*

**Amendments to standards**
An amendment to IAS 39 that permits reclassification of financial assets in certain circumstances.

**New interpretations**
IFRIC 12 and IFRIC 14 contain guidance on accounting for service concession arrangements and pension assets and minimum funding.

## Segmental reporting

The results, assets and liabilities of the regulated Transmission business are reported separately in these regulatory accounting statements and no further segmental analysis is required.

## Critical accounting policies

The application of accounting principles requires estimates, judgments and assumptions to be made 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, these estimates are evaluated using historical experience, consultation with experts and other methods that are considered reasonable in the particular circumstances to ensure compliance with IFRS. Actual results may differ significantly from these 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 accounting policies set out in the consolidated regulatory financial statements.

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 and amortisation of non-current intangible assets can be materially affected by the judgments exercised in determining their estimated economic lives.

Depreciation and amortisation amounted to £221 million in 2008/09 and £244 million in 2007/08.

**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. Total assets at 31 March 2009 were £7,126 million, including £5,981 million of property, plant and equipment and £49 million of intangible assets (31 March 2008: £6,756 million, £5,337 million and £56 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 uninvoiced transmission services supplied to customers. Changes to the estimate of uninvoiced transmission services would have an impact on the reported results.

Estimates of unbilled revenues amounted to £123 million at 31 March 2009 compared with £99 million at 31 March 2008.

**Assets and liabilities carried at fair value**
Derivative financial instruments are carried in the balance sheet at their fair value rather than historical cost.

The fair value of derivative financial instruments is based on market prices, 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**
Derivative financial instruments are used to hedge certain economic exposures arising from movements in exchange and interest rates or other factors that could affect either the value of assets or liabilities or affect future cash flows.

Movements in the fair values of derivative financial instruments may be accounted for using hedge accounting where the relevant eligibility, documentation and effectiveness testing requirements are met. 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**
Pensions obligations recorded in the balance sheet are calculated actuarially using a number of assumptions about the future, including inflation, salary increases, length of service and pension and investment returns, together with the use of a discount rate based on corporate bond yields to calculate the present value of the obligation.

The selection of these assumptions can have a significant impact on both the pension obligation recorded in the balance sheet and on the net charge recorded in the income statement.

**Exceptional items and remeasurements**
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 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, 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 NGET has no control.

**Tax estimates**
The tax charge is based on the profit for the year and tax rates in effect. The determination of appropriate provisions for taxation requires NGET to take into account anticipated decisions of tax authorities and estimate its ability to utilise tax benefits through future earnings and tax planning.

In order to illustrate the impact that changes in assumptions could have on the 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 the annual depreciation charge on property, plant and equipment by £6 million (before tax) and the annual amortisation charge on intangible assets by £1 million (before tax).

**Revenue accruals**
A 10% change in the estimate of unbilled revenues at 31 March 2009 would result in an increase or decrease in 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 £5 million.

**Hedge accounting**
If the gains and losses arising on derivative financial instruments during the year ended 31 March 2009 had not achieved hedge accounting then the profit for the year would have been £50 million higher than that reported net of tax and net assets would have been £70 million higher.

**Pensions**
Pension and post-retirement obligations are sensitive to the actuarial assumptions used. A 0.1% increase in the discount rate, a 0.5% increase in the rate of salary increases or an increase of one year in life expectancy would result in a change in the net obligation of £20 million, £19 million and £37 million and a change in the annual pension cost of £nil, £1 million and £nil respectively.

## Accounting developments

New accounting standards and interpretations which have been issued but not yet adopted by NGET are discussed in the financial statements on pages 38 and 39.

# Corporate governance

As a subsidiary company of National Grid plc, NGET operates within National Grid's corporate governance framework. NGET does not have listed shares and therefore is not subject to the Combined Code on Corporate Governance.

National Grid's corporate governance policies are described in the National Grid plc Annual Report and Accounts 2008/09 under Corporate Governance on page 90.

The Board of National Grid plc considers that it complied in full with the Combined Code during 2008/09.

**Board of NGET**

The Board of NGET is responsible for the overall management and governance of NGET and for ensuring that NGET complies with all relevant laws and regulations, including compliance with the Electricity Transmission Licence.

The Board of NGET meets 6 times a year on a bi-monthly basis. There are no non-executive or independent directors. The Board does not have a separately appointed Chairman. Meetings are chaired by a member of the Board, usually Nick Winser when present, otherwise as appropriate.

The Board of NGET does not have a Nominations, Remuneration or Audit committee. These functions are dealt with by NGET in conjunction with the relevant committee of the National Grid plc Board.

Attendance at meetings of the NGET Board during 2008/09, expressed as number of meetings attended out of number eligible to attend, is set out below.

| | Attendance |
|---|---|
| Nick Winser (chair) | 4 of 6 |
| Malcolm Cooper | 4 of 6 |
| Andy Chapman - resigned 7 July 2008 | 1 of 1 |
| Mark Fairbairn | 6 of 6 |
| Stuart Humphreys - appointed 7 July 2008 | 5 of 5 |
| Paul Whittaker | 6 of 6 |
| Helen Mahy (Company Secretary and general counsel) | 6 of 6 |

The ultimate shareholder of NGET is National Grid plc. Two of the Directors of NGET, Nick Winser, and Mark Fairbairn are also Executive Directors of National Grid plc. Through participation of these Directors at the Board of both companies, the Board of NGET develops an understanding of the views of its shareholder.

The Board of NGET has established a number of committees and sub-committees which assist it in its activities. These include the Transmission Executive Committee and the Finance Committee.

**Transmission Executive Committee**

The Transmission Executive Committee acts within National Grid's overall corporate governance framework and delegated authorities and is responsible for the operational and financial management of the transmission businesses.

During the year, the Transmission Executive Committee moved from meeting monthly to meeting on a quarterly basis. Its membership and attendance at meetings during 2008/09 is set out below.

Attendance is expressed as number of meetings attended out of number eligible to attend, and includes attendance by a nominated deputy.

| | | Attendance |
|---|---|---|
| Nick Winser (Chair) | Executive Director of National Grid | 4 of 5 |
| Thomas Board | HR business partner - Transmission (resigned September 2008) | 2 of 2 |
| Andy Chapman | Finance Director - Transmission (resigned July 2008) | 2 of 2 |
| Louise Farnworth | HR business partner - Transmission (appointed September 2008) | 2 of 3 |
| Madalyn Hanley | IS business partner - Transmission | 4 of 5 |
| Stuart Humphreys | Finance Director - Transmission (appointed July 2008) | 4 of 5 |
| Alison Kay | Commercial Director - Transmission | 5 of 5 |
| Adam Mallalieu | Director of Safety, Health, Environment and Security | 3 of 5 |
| Chris Murray | Director of Asset Management - UK Transmission | 3 of 5 |
| Dave Poulton | Acting Director of UK Construction (from October 2008) | 2 of 2 |
| Masheed Saidi | Director of US Transmission | 3 of 5 |
| Rowan Sharples | Director of UK Construction (resigned October 2008) | 3 of 3 |
| Chris Train | Director of Network Operations - UK Transmission | 5 of 5 |
| Paul Whittaker | UK Director of Regulation | 4 of 5 |

The Transmission Executive Committee has a number of sub-committees dealing with matters such as investment governance and coordination of operations.

**Treasury activities**

Treasury activities for NGET are carried out by the Treasury function of National Grid under policies and guidelines approved by the Finance Committees of the Boards of National Grid plc and of NGET.

More information on treasury policy is provided on page 17.

**Internal control**

The Board of National Grid plc takes overall responsibility for internal control in National Grid including its subsidiary companies. Details of the internal control process are set out on page 96 of the National Grid plc Annual Report and Accounts 2008/09.

**Compliance management**

Compliance management is undertaken on a National Grid wide basis. Details of the compliance management process are set out on page 97 of the National Grid plc Annual Report and Accounts 2008/09.

**Risk management**
Identifying, evaluating and managing risks is integral to the way the business is run. National Grid continues to have a well established enterprise wide 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. An output from this process is information that provides assurance to management and thus helps safeguard National Grid's assets and reputation. NGET participates in this enterprise wide process.

The risk management process continues to be based on both bottom-up and top-down assessments of operational, financial and other business or project risks. From the bottom-up, NGET's business units prepare and maintain risk registers that capture key risks and the actions being taken to manage them. These risk registers are regularly reviewed and discussed by the executive committees for those business units. The key element in the top-down assessments of the enterprise-wide risk profile is the involvement of Directors and other senior management at critical stages in the review process. Their review and debate of bottom-up assessments produces the overall evaluations of the risks that are faced by NGET. In addition, the Executive, the Risk and Responsibility and the Audit Committees of National Grid plc review National Grid's overall risk profile twice a year. The Audit Committee of National Grid plc also reviews the risk management process at least once a year and reports on this to the Board of National Grid plc.

More information on National Grid's risk management process can be found in the National Grid plc Annual Report and Accounts 2008/09.

**Risk factors**
The risk management process has identified the following risk factors that could have a material adverse effect on NGET's business, financial condition, results of operations and reputation. Not all of these factors are within NGET's control. In addition, other factors besides those listed below may have an adverse effect on NGET.

**Changes in law or regulation could have an adverse effect on the results of operations.**
The Transmission business is subject to regulation by governments and other authorities. Consequently, changes in law or regulation could adversely affect the business. 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 other decisions relating to the implications of energy change, the level of permitted revenues and dividend distributions for the business and in relation to proposed business development activities could have an adverse impact on the results of operations, cash flows, the financial condition of the business and the ability to develop the business in the future. For further information, see the Operating and Financial Review and, in particular, the 'External market and regulatory environment' and 'Current and future development' sections.

**Breaches of, or changes in, environmental or health and safety laws or regulations could expose NGET to increased costs, claims for financial compensation and adverse regulatory consequences, as well as damaging NGET's reputation.**
Aspects of NGET's activities are potentially dangerous, including the operation and maintenance electricity transmission networks. Electricity utilities also typically use and generate in their operations hazardous and potentially hazardous products and by-products. In addition, there may be other aspects of operations that are not currently regarded or proved to have adverse effects but could become so; for example, the effects of electric and magnetic fields. NGET is subject to laws and regulations relating to pollution, the protection of the environment, and how hazardous substances and waste materials are used and disposed of. These expose NGET to costs and liabilities relating to its operations and properties whether current, including those inherited from predecessor bodies, or formerly owned by NGET.

NGET is also subject to laws and regulations governing health and safety matters protecting the public and employees. NGET is increasingly subject to regulation in relation to climate change. NGET commits significant expenditure toward complying with these laws and regulations and to meeting obligations under negotiated settlements. If additional requirements are imposed or the ability to recover these costs changes, this could have a material impact on the business and the results of operations and financial position. Any breach of these obligations, or even incidents that do not amount to a breach, could adversely affect results of operations and reputation. For further information about environmental and health and safety matters relating to NGET's business, see the 'Our Responsibility' section of the National Grid website at www.nationalgrid.com.

**Network failure, the inability to carry out critical non-network operations and damage to infrastructure may have significant adverse impacts on both NGET's financial position and reputation.**
NGET 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 NGET 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 NGET's reputation. In addition to these risks, NGET may be affected by other potential events that are largely outside its control such as the impact of weather or unlawful acts of third parties. Weather conditions can affect financial performance and severe weather that causes outages or damages infrastructure will adversely affect operational and potentially business performance and reputation. Terrorist attack, sabotage or other intentional acts

may also damage NGET's assets or otherwise significantly affect corporate activities and as a consequence have an adverse impact on the results of operations.

**NGET's results of operations depend on a number of factors relating to business performance including performance against regulatory targets and the delivery of anticipated cost and efficiency savings.**

Earnings maintenance and growth from regulated businesses will be affected by NGET's ability to meet or exceed efficiency and integration targets and service quality standards set by, or agreed with, its regulators. In addition, from time to time, NGET publishes cost and efficiency savings targets for its business. To meet these targets and standards, NGET must continue to improve operational performance, service reliability and customer service. If NGET does not meet these targets and standards, it may not achieve the expected benefits, its business may be adversely affected and its performance, results of operations and reputation may be harmed.

**Changes to the regulatory treatment of commodity costs may have an adverse effect on the results of operations.**

Changes in commodity prices could potentially impact NGET's energy delivery business. Current regulatory arrangements provide the ability to pass through virtually all of the increased costs related to commodity prices to consumers. However, if regulators were to restrict this ability, it could have an adverse effect on operating results.

**NGET's reputation may be harmed if consumers of energy suffer a disruption to their supply.**

NGET's electricity transmission business is responsible for transporting available electricity. NGET consults with, and provides information to, regulators, governments and industry participants about future demand and the availability of supply. However, where there is insufficient supply, NGET's role is to manage the network safely which, in extreme circumstances, may require it to disconnect consumers, which may damage its reputation.

**NGET's financial position may be adversely affected by a number of factors including restrictions in borrowing and debt arrangements, changes to credit ratings and adverse changes and volatility in the global credit markets.**

NGET is subject to certain covenants and restrictions in relation to listed debt securities and bank lending facilities. NGET is also subject to restrictions on financing that have been imposed by regulators. These restrictions may hinder NGET in servicing the financial requirements of its business. Some of NGET's debt is rated by credit rating agencies and changes to these ratings may affect both its borrowing capacity and the cost of those borrowings.

NGET's business is partly financed through debt and the maturity and repayment profile of debt used to finance investments often does not correlate to cash flows from its assets. Accordingly, NGET relies on access to short-term commercial paper and money markets and longer-term bank and capital markets as sources of finance. The global financial markets are currently experiencing extreme volatility and disruption. A shortage of liquidity, lack of funding, pressure on capital and extreme price volatility across a wide range of asset classes are putting financial institution under considerable pressure and, in certain cases, placing downward pressure on stock prices and credit availability for companies. If NGET is not able to access capital at competitive rates, its ability to finance its operations and implement strategy will be adversely affected.

**NGET's results of operations could be affected by deflation**

NGET's income under price controls is linked to the retail price index. Therefore if the UK economy suffers from a prolonged period of deflation, revenues may decrease, which may not be offset by reductions in operating costs.

**Future funding requirements of pension schemes could adversely affect the results of NGET's operations.**

Substantially all of NGET's employees are members of a defined benefit pension scheme where the scheme assets are held independently of its own financial resources. Estimates of the amount and timing of future funding for this 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 require NGET to make additional contributions to these pension schemes which, to the extent they are not recoverable under price controls, could adversely affect NGET's results of operations.

**New or revised accounting standards, rules and interpretations could have an adverse effect on NGET's reported financial results. Changes in law and accounting standards could increase NGET's effective rate of tax.**

The accounting treatment under International Financial Reporting Standards (IFRS), as adopted by the European Union, of, among other things, replacement expenditure, rate regulated entities, pension and post-retirement benefits, derivative financial instruments and commodity contracts, significantly affect the way NGET reports its financial position and results of operations. New or revised standards and interpretations may be issued which could have a significant impact on the financial results and financial position that is reported. The effective rate of tax paid may be influenced by a number of factors including changes in law and accounting standards, the results of which could increase that rate.

**Customers and counterparties to transactions may fail to perform their obligations, or existing arrangements may be terminated, which could harm NGET's results of operations.**

NGET's operations are exposed to the risk that customers and counterparties to transactions that owe money or commodities to NGET will not perform their obligations, which could cause NGET to incur additional costs.

# Directors' Report

**for the year ended 31 March 2009**

The information in this Directors' Report does not comprise a Directors' Report within the meaning of the Companies Acts. Such a report for National Grid Electricity Transmission plc is included within the company's Annual Report and Accounts 2008/09. As the regulated Transmission business reported on within these regulatory accounting statements does not comprise a legal entity, the information is provided for National Grid Electricity Transmission plc as a whole.

### Directors

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

| | |
|---|---|
| Malcolm Cooper | Appointed July 2007 |
| Mark Fairbairn | Appointed July 2007 |
| Stuart Humphreys | Appointed 7 July 2008 |
| Paul Whittaker | Appointed July 2007 |
| Nick Winser | Appointed April 2003 |

Andy Chapman also served as Director during the period, resigning on 7 July 2008.

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, business and principal risks and uncertainties is contained in the Operating and Financial Review on pages 2 to 22, which are incorporated by reference into this report.

### Material interests in shares

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

### Dividends

An interim dividend of £300 million was paid during the year (2008: £290 million interim dividend). The Directors have not proposed a final dividend.

### Donations

During 2008/09, some £1.4 million (2008: £1.7 million) was invested in support of community initiatives and relationships in the UK, including direct charitable donations of £0.1 million (2008: £0.2 million).

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

### Research and development

Expenditure on research and development was £7.7 million during the year (2008: £3.0 million).

### Financial instruments

Details on the use of financial instruments and financial risk management are included on pages 17 to 19 in the Operating and Financial Review.

### Future developments

Details of future developments are contained in the Operating and Financial Review.

### Disability

Through National Grid's inclusion and diversity programme, NGET 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

NGET, 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. NGET 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 NGET's policy to include in contracts or other agreements, terms of payment with suppliers. Once agreed, NGET aims to abide by these terms of payment. The average creditor payment period at 31 March 2009 was 9 days (14 days at 31 March 2008).

**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 2009 will be issued separately to shareholders.

On behalf of the Board

**Stuart Humphreys**
Director
29 July 2009

National Grid Electricity Transmission plc
1-3 Strand London WC2N 5EH
Registered in England and Wales Number 2366977

# Contents of financial statements

## Directors' statement and independent auditors' report



## Consolidated financial statements under IFRS

# Statement of Directors' responsibilities

The Directors of National Grid Electricity Transmission plc are required by Condition B1 of the Transmission Licence granted under section 6(1)(b) of the Electricity Act 1989 to prepare regulatory accounting statements for each financial year which comply with the requirements set out in that condition.

The Directors consider that, in preparing the regulatory accounting statements, National Grid Electricity Transmission plc has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgments and estimates and all applicable accounting standards have been followed.

The Directors have responsibility for preparing the regulatory accounting statements on the going concern basis, unless it is inappropriate to presume that National Grid Electricity Transmission plc will continue in business. Therefore, these regulatory accounting statements have been prepared on the going concern basis.

The Directors have responsibility for ensuring that National Grid Electricity Transmission plc and its related undertakings keep accounting records in such form that revenues, costs, assets, liabilities, reserves and provisions of, or reasonably attributable to, the consolidated Transmission business are separately identifiable in the books of National Grid Electricity Transmission plc and its related undertakings from those of any other business.

The Directors have responsibility for ensuring that the regulatory accounting statements fairly present the financial position, financial performance and cash flows of, or reasonably attributable to, the consolidated Transmission business.

The Directors have responsibility to ensure that, so far as reasonably practicable, the regulatory accounting statements have the same form and content in respect of the business to which they relate as the equivalent statutory accounts of National Grid Electricity Transmission plc, and that they comply in all material respects with all relevant accounting standards currently in force which have been issued or adopted by the International Accounting Standards Board.

The Directors have responsibility to ensure that the regulatory accounting statements include an income statement, a statement of changes in equity and, if appropriate, a statement of recognised income and expense, a balance sheet and a cash flow statement, including notes thereto. The Directors also have responsibility to ensure that the regulatory accounting statements include a statement of accounting policies adopted, a corporate governance statement, a directors' report and an operating and financial review.

The Directors have responsibility to ensure that the regulatory accounting statements show separately and in appropriate detail the amounts of any revenues, costs, assets, liabilities, reserves or provisions that have been charged from or to any non-National Grid Electricity Transmission plc business of National Grid, or that have been determined by apportionment, where they relate to goods or services received or supplied for the purposes of the regulated business.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and to detect fraud and irregularities.

The Directors, having prepared the regulatory accounting statements, have requested the auditors to take whatever steps and to undertake whatever inspections they consider to be appropriate for the purpose of enabling them to give their audit report.

The Directors confirm that the Audit Committee of National Grid plc continues to review the adequacy of the system of internal financial controls adopted by National Grid Electricity Transmission plc.

On behalf of the Board

**Stuart Humphreys**
Director
29 July 2009

# Independent Auditors' report to the Gas and Electricity Markets Authority and to the Directors of National Grid Electricity Transmission plc

We have audited the regulatory accounting statements of National Grid Electricity Transmission plc ('the Company') for the year ended 31 March 2009 on pages 32 to 70 which comprise the accounting policies, adoption of new accounting standards, consolidated income statement, consolidated balance sheet, consolidated statement of recognised income and expense, consolidated cash flow statement and the related notes to the regulatory accounting statements.

This report is made, on terms that have been agreed, solely to the Company and the Gas and Electricity Markets Authority ('the Authority') in accordance with Standard Special Condition B1 ('the Condition') of the Regulatory Licence granted to the Company, being the Electricity Transmission Licence. Our audit work has been undertaken so that we might state to the Company and the Authority those matters we have agreed to state to them in our report, in order to: (a) assist the Company to meet its obligations under the Regulatory Licence to procure such a report; and (b) to facilitate the carrying out by the Authority of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Authority, for our audit work, for this report or for the opinions we have formed.

**Basis of preparation**

The regulatory accounting statements have been prepared under the historical cost convention and in accordance with the Condition and the accounting policies set out on pages 21 and 32.

Note 28 includes disclosure of amounts charged to or from other businesses of National Grid plc or amounts determined by apportionment. The Condition requires these disclosures to be made to the Authority, but allows the Company to remove these disclosures from the information made available to the public as per paragraph 10 of the Condition.

The regulatory accounting statements are separate from the statutory financial statements of the Company.

**Respective responsibilities of the Gas and Electricity Markets Authority, the Directors and Auditors**

The nature, form and content of regulatory accounting statements are determined by the Authority. It is not appropriate for the auditors or the directors to assess whether the nature of the information being reported upon is suitable or appropriate for the Authority's purposes. Accordingly we make no such assessment.

The directors of the Company are responsible for preparing the regulatory accounting statements and for compliance with the Condition, as described on page 29.

Our responsibility is to audit the regulatory accounting statements in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board, except as stated in the 'Basis of audit opinion', below and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities'.

We report to you our opinion as to whether the regulatory accounting statements have been properly prepared in accordance with the Condition and the accounting policies, and whether they fairly present the financial position, financial performance and cash flows of, or reasonably attributable to, its Electricity Transmission business. We also report to you if the Company has not kept proper accounting records or if we have not received all the information and explanations we require for our audit.

We read the other information contained in the regulatory accounting statements, on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the regulatory accounting statements. The other information comprises: about regulatory accounting statements; the Operating and Financial Review; the corporate governance statement and the Directors' Report.

**Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the regulatory accounting statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the regulatory accounting statements and of whether the accounting policies are 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 regulatory accounting statements are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of the regulatory accounting statements are determined by the Authority, we did not evaluate the overall adequacy of the presentation of information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK and Ireland).

Our opinion on the regulatory accounting statements is separate from our opinion on the statutory financial statements of the Company on which we reported on 5 June 2009, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our 'Statutory' audit) was made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a Statutory auditors' report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

The Condition requires the regulatory accounting statements to be drawn up on the basis set out therein, including the separate disclosure of amounts charged to or from other businesses of National Grid plc or determined by apportionment. The Directors of National Grid Electricity Transmission plc are responsible for determining the bases of charges and apportionments, which requires a number of judgements and assumptions to be made. We do not give an opinion on the appropriateness of the bases of charges and apportionments.

**Opinion**

In our opinion, on the basis set out above, the regulatory accounting statements fairly present in accordance with the Condition and the accounting policies set out on pages 21 and 32, the state of National Grid Electricity Transmission plc's Electricity Transmission business at 31 March 2009 and profit and cash flows of its Electricity Transmission business for the year then ended and have been properly prepared in accordance with the Condition and the accounting policies.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Cornwall Court
19 Cornwall Street
Birmingham
B3 2DT

29 July 2009

*1. The maintenance and integrity of the Company web site is the responsibility of the Directors and the maintenance and integrity of the Authority's web site is the responsibility of the Authority; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the regulatory accounting statements since they were initially presented on the web sites.*

*2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements and regulatory accounting statements may differ from legislation in other jurisdictions.*

# Accounting policies

**for the year ended 31 March 2009**

## A. Basis of preparation of consolidated financial statements under IFRS

These regulatory consolidated financial statements have been prepared in accordance with Standard Condition B1 of National Grid Electricity Transmission plc's Electricity Transmission Licence granted under the Electricity Act 1989 and 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 2009 and in accordance with applicable United Kingdom law and Article 4 of the European Union IAS regulation. The 2008 comparative financial information has also been prepared on this basis.

These consolidated regulatory financial statements were approved for issue by the Board of Directors on 29 July 2009.

The November 2008 amendment to IAS 39 and IFRS 7 on the reclassification of financial assets, which is effective 1 July 2008, is still subject to endorsement by the European Union. The amendment relating to the reclassification of financial assets does not have an impact on consolidated results or asset or liabilities of the Company and therefore these consolidated financial statements comply with both IFRS as issued by the IASB and IFRS as adopted by the European Union.

The consolidated regulatory financial statements have been prepared on a historical cost basis, except for the recording of pension liabilities and the revaluation of derivative 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.

**Attribution of revenue, costs, assets, liabilities and equity**

These regulatory financial statements contain arbitrary apportionments of certain centrally held balances of National Grid Electricity Transmission plc which are not specifically attributable to the Transmission business. The centrally held balances and the method of apportionment are as follows:

| Balance | Method of apportionment | |
|---|---|---|
| | year ended 31 March 2009 | year ended 31 March 2008 |
| Net debt (borrowings, derivatives, bank overdrafts net of cash, cash equivalents and financial investments). | Fixed asset RAV at the balance sheet date. | Fixed asset net book value at the balance sheet date. |
| Interest payable and receivable relating to net debt. | Fixed asset RAV at the balance sheet date. | Fixed asset net book value at the balance sheet date. |
| | years ended 31 March 2008 and 2009 | |
| Intercompany balances. | Fixed asset net book value at the balance sheet date. | |
| Deferred tax liabilities. | Fixed asset net book value at the balance sheet date. | |
| Retirement benefit obligations | According to the Licencee's final proposals. | |
| Taxation charge and corporate tax payable | Calculation specific to each business | |
| Total equity (called up share capital, share premium account, retained profits and other reserves). | Balancing item. | |

## 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) 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.

## 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.

## 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 |

## E. Property, plant and equipment

Property, plant and equipment is recorded at cost, 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 as well as the cost of any associated asset retirement obligations.

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 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 40 |
| Plant and machinery | |
| – towers | 40 to 60 |
| – substation plant, overhead lines and cables | 40 to 50 |
| – protection, control and communications equipment | 15 to 25 |
| Motor vehicles and office equipment | up to 5 |

## 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. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and establishes provisions where appropriate  on the basis of amounts expected to be paid to the tax authorities.

**Deferred tax**

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. Inventories

Inventories are stated at the lower of cost and net realisable value. Cost comprises cost of direct materials and those costs that have been incurred in bringing the inventories to their present location and condition.

## I. Revenue

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

The sales value for the transmission of electricity is largely determined from the amount of electricity transmitted in the year and system capacity sold for the year, evaluated at contractually determined prices or recovery rates. 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. Pensions

For defined benefit retirement schemes, the cost of providing benefits is determined using the projected unit method, with actuarial valuations being carried out at each balance sheet date.

Current service cost is recognised in operating costs in the period in which the defined benefit obligation increases as a result of employee services.

Actuarial gains and losses are recognised in full in the period in which they occur in the statement of recognised income and expense.

Past service costs are recognised immediately to the extent that benefits are already vested. Otherwise such costs are amortised on a straight-line basis over the period until the benefits vest.

Settlements are recognised when a transaction is entered into that eliminates all further legal or constructive obligations for benefits under a scheme.

Curtailments are recognised when a commitment is made to a material reduction in the number of employees covered by a scheme.

The retirement benefit obligations recognised in the balance sheet represent the present value of the defined benefit obligations, as reduced by the fair value of scheme assets and any unrecognised past service cost.

The expected return on scheme assets and the unwinding of the discount on defined benefit obligations are recognised within interest income and expense respectively.

## K. Leases

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

Assets held under finance leases are recognised at their fair value or, if lower, the present value of minimum lease payments on inception. The corresponding liability is recognised as a finance lease obligation within borrowings. Rental payments are apportioned between finance costs and reduction in the finance lease obligation, so as to achieve a constant rate of interest. Assets held under finance leases are depreciated over the shorter of their useful life and the lease term.

## L. 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.

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.

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 derivative 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 the changes in fair value are included in the income statement in the period they arise.

Where there are 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.

## M. Hedge accounting

The Company enters into both derivative financial instruments (derivatives) and non-derivative financial instruments in order to manage interest rate and foreign currency exposures 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.

## N Share-based payments

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

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

## O. 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.

## P. 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 activities, but which does not represent revenue.

## Q. 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.

## R. Dividends

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

## S. 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 are:

- The categorisation of certain items as exceptional items and remeasurements and the definition of adjusted earnings – note 2.
- The exemptions adopted on transition to IFRS on 1 April 2004.
- Hedge accounting – accounting policy M.

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.
- Estimation of liabilities for pension schemes – note 3.
- Valuation of financial instruments and derivatives – notes 8, 11 and 24.
- Revenue recognition and assessment of unbilled revenue – accounting policies I.
- Recoverability of deferred tax assets – accounting policy G and note 16.

# Adoption of new accounting standards

**New IFRS accounting standards and interpretations adopted in 2008/09**

During the year ended 31 March 2009, 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 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 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. |
| Amendment to IAS 39 Financial Instruments: Recognition and measurement and IFRS 7 financial instruments: Disclosures on reclassification of financial assets. | Permits reclassification of financial assets in certain circumstances. |

**New IFRS accounting standards and interpretations not yet adopted**

NGET has yet to adopt the following standards and interpretations. NGET has a number of transactions that fall within the scope of IFRIC 18 'Transfer of assets from customers' and the impact of this interpretation is being considered. The other standards and interpretations listed below are not expected to have a material impact on consolidated results or assets and liabilities.

| | |
|---|---|
| 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 achieves convergence with the US accounting standard, SFAS 131 'Disclosures about segments of an enterprise and related information' with minor differences. IFRS 8 has been adopted by the Company with effect from 1 April 2009. |
| IAS 23 revised 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. IAS 23 revised has been adopted by the Company with effect from 1 April 2009. |
| 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 has been adopted by the Company with effect from 1 April 2009. |
| IAS 1 revised 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. IAS 1 revised has been adopted by the Company with effect from 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. IFRS 3R will be adopted by the Company on 1 April 2010, subject to endorsement by the European Union. |
| 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. IAS 27R will be adopted by the Company on 1 April 2010, subject to endorsement by the European Union. |
| 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. The amendment to IFRS 2 has been adopted by the Company with effect from 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 have been adopted by the company from 1 April 2009. |

| | |
|---|---|
| Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards and IAS 27 Consolidated and Separate Financial Statements of the cost of an investment in a subsidiary, Jointly Controlled Entity or Associate. | Permits investments to be recognised on first-time adoption of IFRS at cost or deemed cost (fair value of previous GAAP carrying amount) and removes the requirement to recognise dividends out of pre-acquisition profits as a reduction in the cost of investment. The amendments to IFRS 1 and IAS 27 have been adopted by the Company with effect from 1 April 2009. |
| Improvements to IFRS 2008 | Contains amendments to various existing standards. The amendments are effective, in most cases, from 1 January 2009, or otherwise for annual periods beginning on or after 1 July 2009. |
| IFRIC 15 on agreements for the construction of real estate | Addresses the timing of revenue recognition for entities engaged in the construction of real estate for their customers. IFRIC 15 will be adopted by the Company with effect from 1 April 2009, subject to endorsement by the European Union. |
| IFRIC 16 on hedges of a net investment in a foreign operation. | Clarifies that a hedged risk may be designated at any level in a group and hedging instruments may be held by any company in a group (except the foreign entity being hedged), that net investment hedge accounting may not be adopted in respect of a presentational currency and that on disposal the amounts to be reclassified from equity to profit or loss are any cumulative gain or loss on the hedging instrument and the cumulative translation difference on the foreign operation disposed of. IFRIC 16 will be adopted by the Company with effect from 1 April 2009, subject to endorsement by the European Union. |
| Amendments to IAS 39 financial instruments: Recognition and measurement on eligible hedged items. | Prohibits designating inflation as a hedgeable component of an instrument, unless cash flows relating to the separate inflation component are contractual and also prohibits the designation of a purchased option in its entirety as the hedge of a one-sided risk in a forecast transaction. The amendment to IAS 39 will be adopted by the Company with effect from 1 April 2010, subject to endorsement by the European Union. |
| Amendment to IAS 39 Financial Instruments: Recognition and measurement: Reclassification of Financial Assets: Effective Date and Transition. | Clarifies the effective date of the reclassification of financial assets. The amendment is effective under IFRS but has not yet been endorsed by the European Union and has therefore not been adopted by the Company. Adoption of the amendment would not have any impact on results or assets and liabilities. |
| Revised IFRS 1 on first-time adoption of IFRS | Changes the structure while retaining the substance, of the previously issued version of IFRS 1. The revised version of IFRS 1 will be adopted by the Company with effect from 1 April 2010, subject to endorsement by the European Union. |
| IFRIC 17 on the distribution of non-cash assets to owners | Requires such a distribution to be measured at the fair value of the asset and any difference between the carrying amount of the asset and its fair value to be recognised in the profit or loss. IFRIC 17 will be adopted by the Company with effect from 1 April 2010. |
| IFRIC 18 on the transfer of asset from customers | Addresses arrangements whereby an entity receives items of property, plant or equipment or cash which the entity must use to connect customers to a network or provide access to a supply of goods or services, or both. IFRIC 18 will be adopted by the Company with effect from 1 July 2009, subject to endorsement by the European Union. |
| Amendment to IFRS 7 on improving disclosures about financial instruments | Enhances disclosures about fair value and liquidity risk. The amendment will be adopted by the Company with effect from 1 April 2009, subject to endorsement by the European Union. |
| Amendments to IAS 39 and IFRIC 9 on embedded derivatives | Requires reassessments of whether an embedded derivative should be separated out if a financial asset is reclassified out of the fair value through profit or loss category. The amendment will be adopted by the Company with effect from 1 April 2009, subject to endorsement by the European Union. |
| Improvements to IFRS 2009 | Contains amendments to various existing standards. The amendments will be adopted by the Company with effect from 1 April 2010, subject to endorsement by the European Union. |

# Consolidated income statement

**for the years ended 31 March**

| | Notes | 2009 £m | 2009 £m | 2008 £m | 2008 £m |
|---|---|---|---|---|---|
| **Revenue** | | | **2,556** | | 2,106 |
| Operating costs | 1 | | **(1,848)** | | (1,461) |
| **Operating profit** | | | | | |
| Before exceptional items | | **717** | | 650 | |
| Exceptional items | 2 | **(9)** | | (5) | |
| **Total operating profit** | | | **708** | | 645 |
| Interest income and similar income | 4 | | **117** | | 141 |
| Interest expense and other finance costs | | | | | |
| Before exceptional items and remeasurements | 4 | **(303)** | | (312) | |
| Exceptional items and remeasurements | 2, 4 | **(32)** | | 5 | |
| | 4 | | **(335)** | | (307) |
| **Profit before taxation** | | | | | |
| Before exceptional items and remeasurements | | **531** | | 479 | |
| Exceptional items and remeasurements | 2, 4 | **(41)** | | - | |
| **Total profit before taxation** | | | **490** | | 479 |
| Taxation | | | | | |
| Before exceptional items and remeasurements | 5 | **(149)** | | (140) | |
| Exceptional items and remeasurements | 2, 5 | **(4)** | | 47 | |
| Total taxation | 5 | | **(153)** | | (93) |
| **Profit after taxation** | | | | | |
| Before exceptional items and remeasurements | | **382** | | 339 | |
| Exceptional items and remeasurements | 2 | **(45)** | | 47 | |
| **Profit for the year** | | | **337** | | 386 |

The notes on pages 44 to 70 form part of the consolidated financial statements.

# Consolidated balance sheet

**at 31 March**

| | Notes | **2009** **£m** | 2008 £m |
|---|---|---|---|
| **Non-current assets** | | | |
| Intangible assets | 6 | **49** | 56 |
| Property, plant and equipment | 7 | **5,981** | 5,337 |
| Derivative financial assets | 8 | **134** | 20 |
| Total non-current assets | | **6,164** | 5,413 |
| **Current assets** | | | |
| Inventories | 9 | **29** | 16 |
| Trade and other receivables | 10 | **152** | 328 |
| Financial investments | 11 | **360** | 914 |
| Derivative financial assets | 8 | **34** | 76 |
| Cash and cash equivalents | 12 | **387** | 9 |
| Total current assets | | **962** | 1,343 |
| **Total assets** | | **7,126** | 6,756 |
| **Current liabilities** | | | |
| Borrowings | 13 | **(89)** | (925) |
| Derivative financial liabilities | 8 | **(24)** | (6) |
| Trade and other payables | 14 | **(550)** | (725) |
| Provisions | 17 | **(6)** | (4) |
| Total current liabilities | | **(669)** | (1,660) |
| **Non-current liabilities** | | | |
| Borrowings | 13 | **(4,623)** | (3,376) |
| Derivative financial liabilities | 8 | **(55)** | (48) |
| Other non-current liabilities | 15 | **(208)** | (134) |
| Deferred tax liabilities | 16 | **(711)** | (667) |
| Pension obligations | 3 | **(403)** | (403) |
| Provisions | 17 | **(12)** | (11) |
| Total non-current liabilities | | **(6,012)** | (4,639) |
| **Total liabilities** | | **(6,681)** | (6,299) |
| **Net assets** | | **445** | 457 |
| | | | |
| **Total equity** | 18 | **445** | 457 |

These regulatory accounting statements were approved by the Board of Directors of National Grid Electricity Transmission plc on 29 July 2009 and were signed on its behalf by:

**Nick Winser** Director

**Stuart Humphreys** Director

# Consolidated statement of recognised income and expense

**for the years ended 31 March**

| | Notes | 2009 £m | 2008 £m |
|---|---|---|---|
| Actuarial (losses)/gains | 3 | **(77)** | 50 |
| Net losses taken to equity in respect of cash flow hedges | | **(33)** | (19) |
| Tax on items taken directly to or transferred from equity | 5 | **31** | (11) |
| **Net (expense)/income recognised directly in equity** | | **(79)** | 20 |
| Profit for the year | | **337** | 386 |
| **Total recognised income and expense for the year** | | **258** | 406 |

# Consolidated cash flow statement

**for the years ended 31 March**

| | Notes | **2009** **£m** | 2008 £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Total operating profit | | **708** | 645 |
| Adjustments for: | | | |
| Exceptional items and remeasurements | | **9** | 5 |
| Depreciation and amortisation | | **221** | 244 |
| Property disposals | | **(7)** | - |
| Share based payment charge | | **2** | 3 |
| Changes in working capital | | **254** | (70) |
| Changes in pension obligations | | **(97)** | (39) |
| Cash flows relating to exceptional items | | **(5)** | (5) |
| Cash generated from operations | | **1,085** | 783 |
| Tax (paid)/received | | **(189)** | 24 |
| **Net cash inflow from operating activities** | | **896** | 807 |
| **Cash flows from investing activities** | | | |
| Purchases of intangible assets | | **(8)** | (15) |
| Purchases of property, plant and equipment | | **(853)** | (702) |
| Disposal of property, plant and equipment | | **4** | - |
| Interest received | | **30** | 55 |
| Purchases of financial investments | | **(339)** | (516) |
| Disposal of financial investments | | **895** | - |
| **Net cash flow used in investing activities** | | **(271)** | (1,178) |
| **Cash flows from financing activities** | | | |
| Proceeds from loans received | | **2,298** | 199 |
| Repayment of loans | | **(2,125)** | - |
| Net movements in short-term borrowings and derivatives | | **27** | 209 |
| Interest paid | | **(184)** | (187) |
| **Net cash flow from financing activities** | | **16** | 221 |
| **Net increase/(decrease) in cash and cash equivalents** | | **641** | (150) |
| Transfers (i) | | **(270)** | (276) |
| Net increase/(decrease) in cash and cash equivalents - after transfers | | **371** | (426) |
| Cash and cash equivalents at the start of the year (ii) | | **9** | 435 |
| Transfers (i) | | **3** | - |
| Cash and cash equivalents at the start of the year - after transfers (ii) | | **12** | 435 |
| **Net cash and cash equivalents at the end of the year (ii)** | 12 | **383** | 9 |

(i) Transfers represent the reallocation of balances between the regulated Transmission business and other businesses carried on by NGET, principally arising from dividend payments made by NGET.

(ii) Net of bank overdrafts of £4m (2008: £nil, 2007: £26m).

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

## 1. Operating costs

| | Before exceptional items | | Exceptional items | | Total | |
|---|---|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 | **2009** | 2008 |
| | **£m** | £m | **£m** | £m | **£m** | £m |
| Depreciation of property, plant and equipment | **205** | 220 | **-** | - | **205** | 220 |
| Amortisation of intangible assets | **16** | 24 | **-** | - | **16** | 24 |
| Payroll costs | **110** | 89 | **1** | 5 | **111** | 94 |
| Other operating charges: | | | | | | |
| Rates | **101** | 97 | **-** | - | **101** | 97 |
| Electricity transmission services scheme direct costs | **904** | 575 | **-** | - | **904** | 575 |
| Payments to Scottish electricity transmission network owners | **290** | 270 | **-** | - | **290** | 270 |
| Other | **213** | 181 | **8** | - | **221** | 181 |
| | **1,839** | 1,456 | **9** | 5 | **1,848** | 1,461 |
| Operating costs include: | | | | | | |
| Consumption of inventories | | | | | **6** | 4 |
| Research expenditure | | | | | **8** | 3 |
| Operating lease rentals - other | | | | | **6** | 5 |

### (a) Payroll costs

| | **2009** | 2008 |
|---|---|---|
| | **£m** | £m |
| Wages and salaries | **111** | 97 |
| Social security costs | **11** | 10 |
| Other pension costs | **14** | 21 |
| Share-based payments | **2** | 3 |
| Severance costs (excluding pension costs) | **3** | 3 |
| | **141** | 134 |
| Less: payroll costs capitalised | **(30)** | (40) |
| | **111** | 94 |

# 1. Operating costs continued

### (b) Average number of employees

| | 2009 Number | 2008 Number |
|---|---|---|
| United Kingdom | **2,352** | 2,288 |

Information is not available on the number of people employed in the Transmission business, as many of NGET's activities are undertaken on a centralised or shared service basis. NGET employee numbers have therefore been apportioned relative to wages and salaries in order to arrive at numbers for the Transmission business.

### (c) Key management compensation

| | 2009 £m | 2008 £m |
|---|---|---|
| Salaries and short-term employee benefits | **2** | 1 |
| Post-employment benefits | **1** | 1 |
| Share-based payments | **1** | 1 |
| | **4** | 3 |

Key management comprises the board of directors of NGET.

### (d) Directors' emoluments

The business reported in these regulatory statements is not a legal entity with statutory directors, and therefore there are no relevant directors' emoluments. Information on the emoluments of the directors of NGET are provided in the statutory accounts of NGET on page 43.

### (e) Auditors' remuneration

| | 2009 £m | 2008 £m |
|---|---|---|
| Audit services | | |
| Audit fee of parent company and consolidated financial statements | **0.2** | 0.2 |
| Other services | | |
| Other services supplied pursuant to legislation | **0.2** | 0.3 |

The amounts shown relate to NGET. 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).

## 2. Exceptional items and remeasurements

| | **2009** | 2008 |
|---|---|---|
| | **£m** | £m |
| Exceptional items - restructuring costs (i) | **(9)** | (5) |
| **Total exceptional items included within operating profit** | **(9)** | (5) |
| Remeasurements - net (losses)/gains on derivative financial instruments (iii) | **(32)** | 5 |
| **Total exceptional items and remeasurements included within finance costs** | **(32)** | 5 |
| **Total exceptional items and remeasurements before taxation** | **(41)** | - |
| Exceptional tax item - deferred tax credit arising from reduction in UK tax rate (iv) | **-** | 47 |
| Exceptional tax item - deferred tax charge arising from change in the IBAs regime (iv) | **(15)** | - |
| Tax on exceptional items - restructuring costs (i) | **2** | 2 |
| Tax on remeasurements - derivative financial instruments (iii) | **9** | (2) |
| **Tax on exceptional items and remeasurements** | **(4)** | 47 |
| **Total exceptional items and remeasurements after taxation** | **(45)** | 47 |
| Total exceptional items after taxation | **(22)** | 44 |
| Total remeasurements after taxation | **(23)** | 3 |
| **Total exceptional items and remeasurements after taxation** | **(45)** | 47 |

(i) Restructuring costs relate to planned cost reduction programmes.

(ii) Remeasurements - net (losses)/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.

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

(iv) The exceptional tax charge in the period arose from changes to the industrial buildings allowances (IBA) in the 2008 Finance Act. This resulted in an increase in deferred tax liabilities.

## 3. Pensions

Substantially all of NGET's employees are members of the National Grid Electricity Group of the Electricity Supply Pension Scheme which is a defined benefit pension scheme. For further details of the nature and terms of this scheme and the actuarial assumptions used to value the associated assets and pension obligations, refer to note 22.

The amounts recognised in the consolidated income statement with respect to pensions are as follows:

| | **2009** **£m** | 2008 £m |
|---|---|---|
| **Defined benefit scheme costs** | | |
| Current service cost | **12** | 18 |
| Curtailment gains on redundancies | **(1)** | (1) |
| Cost of contractual termination on redundancies | **2** | 3 |
| Other augmentation | **1** | 1 |
| Total in payroll costs - continuing | **14** | 21 |
| Interest cost | **111** | 96 |
| Expected return on plan assets | **(92)** | (88) |
| Total in finance costs - continuing | **19** | 8 |

The amounts recognised in the consolidated statement of recognised income and expense with respect to pensions are as follows:

| | **2009** **£m** | 2008 £m |
|---|---|---|
| Actuarial (loss)/gain during the year | **(77)** | 50 |
| Cumulative actuarial (loss)/gain | **(32)** | 39 |

The amounts recognised in the consolidated balance sheet with respect to pensions are as follows:

| | **2009** **£m** | 2008 £m |
|---|---|---|
| Present value of funded obligations | **(1,519)** | (1,693) |
| Fair value of plan assets | **1,130** | 1,304 |
| | **(389)** | (389) |
| Present value of unfunded obligations | **(14)** | (14) |
| Net liability in the balance sheet | **(403)** | (403) |
| | | |
| **Changes in the present value of the defined benefit obligation** | | |
| Opening defined benefit obligation (including unfunded obligations) | **(1,707)** | (1,800) |
| Current service cost | **(12)** | (18) |
| Interest cost | **(111)** | (96) |
| Actuarial gains | **221** | 126 |
| Net increase in liabilities from redundancies | **(1)** | (2) |
| Employee contributions | **(6)** | (6) |
| Benefits paid (including unfunded obligations) | **81** | 82 |
| Net transfers | **3** | 8 |
| Other augmentations | **(1)** | (1) |
| Closing defined benefit obligation (including unfunded obligations) | **(1,533)** | (1,707) |
| | | |
| **Changes in the fair value of plan assets** | | |
| Opening fair value of plan assets | **1,304** | 1,318 |
| Expected return on plan assets | **92** | 88 |
| Actuarial losses | **(298)** | (76) |
| Employer contributions | **110** | 58 |
| Employee contributions | **6** | 6 |
| Benefits paid (including unfunded obligations) | **(81)** | (82) |
| Net transfers | **(3)** | (8) |
| Closing fair value of plan assets | **1,130** | 1,304 |
| | | |
| **Actual return on plan assets** | **(205)** | 12 |
| | | |
| **Expected contributions to defined benefit plans in the following year** | **19** | 19 |

## 4. Finance income and costs

| | 2009 £m | 2008 £m |
|---|---|---|
| Interest income and similar income | | |
| Expected return on pension plan assets | **90** | 86 |
| Interest income on financial instruments: | | |
| Interest income from bank deposits and other financial assets | **27** | 55 |
| Interest income and similar income | **117** | 141 |
| Interest expense and other financial costs | | |
| Interest on pension plan obligations | **(111)** | (96) |
| Interest expense on financial liabilities held at amortised cost: | | |
| Interest on bank loans and overdrafts | **(23)** | (25) |
| Interest on other borrowings | **(233)** | (227) |
| Interest on derivatives | **(8)** | (17) |
| Less: interest capitalised (i) | **72** | 53 |
| Interest expense | **(303)** | (312) |
| Net (losses)/gains on derivative financial instruments included in remeasurements: | | |
| Ineffectiveness on derivatives designated as fair value hedges (ii) | **(34)** | 3 |
| Ineffectiveness on derivatives designated as cash flow hedges | **4** | 1 |
| On derivatives not designated as hedges or ineligible for hedge accounting | **(2)** | 1 |
| Net (losses)/gains on derivative financial instruments included in remeasurements (iii) | **(32)** | 5 |
| Interest expense and other finance costs | **(335)** | (307) |
| **Net finance costs** | **(218)** | (166) |
| Comprising: | | |
| Interest income and similar income | **117** | 141 |
| Interest expense and other finance costs | | |
| Before exceptional items and remeasurements | **(303)** | (312) |
| Exceptional items and remeasurements | **(32)** | 5 |
| | **(218)** | (166) |

(i) Interest on funding attributable to assets in the course of construction was capitalised during the year at a rate of 6.15% (2008: 6.4%).

(ii) Includes a net gain on instruments designated as fair value hedges of £63m (2008: £15m) less a net loss of £97m (2008: £12m) arising from the fair value adjustments to the carrying value of debt.

(iii) Includes a net foreign exchange loss on financing activities of £68m (2008: £84m loss). These amounts are offset by foreign exchange gains and losses on derivative financial instruments measured at fair value.

## 5. Taxation

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

| | Before exceptional items and remeasurements | | Exceptional items and remeasurements | | Total | |
|---|---|---|---|---|---|---|
| | **2009 £m** | 2008 £m | **2009 £m** | 2008 £m | **2009 £m** | 2008 £m |
| United Kingdom | | | | | | |
| Corporation tax at 28% (2008: 30%) | **87** | 143 | **(11)** | - | **76** | 143 |
| Corporation tax adjustment in respect of prior years | **4** | (56) | **-** | - | **4** | (56) |
| | **91** | 87 | **(11)** | - | **80** | 87 |
| Deferred tax | **62** | 3 | **-** | - | **62** | 3 |
| Deferred tax charge arising from changes in the UK IBAs regime | **-** | - | **15** | - | **15** | - |
| Deferred tax credit arising from reduction in UK tax rates | **-** | - | **-** | (47) | **-** | (47) |
| Deferred tax adjustment in respect of prior years | **(4)** | 50 | **-** | - | **(4)** | 50 |
| | **58** | 53 | **15** | (47) | **73** | 6 |
| **Total tax charge** | **149** | 140 | **4** | (47) | **153** | 93 |

**Taxation on items (credited)/charged to equity**

| | **2009 £m** | 2008 £m |
|---|---|---|
| Deferred tax credit on revaluation of cash flow hedges | **(9)** | (3) |
| Deferred tax (credit)/charge on actuarial gains/losses | **(22)** | 14 |
| Tax (credit)/charge recognised in consolidated statement of recognised income and expense | **(31)** | 11 |
| Deferred tax charge on share-based payments recognised directly in equity | **2** | 6 |
| Corporation tax credit on share-based payments recognised directly in equity | **(1)** | (3) |
| | **(30)** | 14 |

The tax charge for the year after exceptional items and remeasurements is higher (2008: lower) than the standard rate of corporation tax in the UK of 28% (2008: 30%). The differences are explained below:

| | **Before exceptional items and remeasure-ments 2009 £m** | **After exceptional items and remeasure-ments 2009 £m** | Before exceptional items and remeasure-ments 2008 £m | After exceptional items and remeasure-ments 2008 £m |
|---|---|---|---|---|
| Profit before taxation | | | | |
| Before exceptional items and remeasurements | **531** | **531** | 479 | 479 |
| Exceptional items and remeasurements | **-** | **(41)** | - | - |
| Profit before taxation from continuing operations | **531** | **490** | 479 | 479 |
| Profit on continuing operations multiplied by the rate of corporation tax in the UK of 28% (2008: 30%) | **149** | **137** | 144 | 144 |
| Effects of: | | | | |
| Adjustments in respect of previous years | **-** | **-** | (6) | (6) |
| Expenses not deductible for tax purposes | **-** | **16** | 4 | 4 |
| Remeasurement of deferred tax - change in UK tax rate | **-** | **-** | - | (47) |
| Other | **-** | **-** | (2) | (2) |
| Total taxation from continuing operations | **149** | **153** | 140 | 93 |
| | **%** | **%** | % | % |
| At the effective income tax rate | **28.1** | **31.2** | 29.2 | 19.4 |

## 5. Taxation (continued)

**Factors that may affect future tax charges**

A number of changes to the UK Corporation Tax system were announced in the April 2009 Budget Statement which are expected to be enacted in the Finance Act 2009.

These changes include temporary changes to the capital allowances regime and the introduction of a system for taxing foreign profits, which is expected to bring in a dividend exemption and a worldwide debt cap.

The dividend exemption is likely to be available for both UK and foreign distributions, falling within an exempt classification, received on or after 1 July 2009. This is not expected to have a material effect on our future tax charge.

The worldwide debt cap is likely to restrict the amount of finance expense available for UK tax purposes, based on the consolidated finance expense, and is expected to apply for the accounting period ended 31 March 2011 onwards. We are in the process of evaluating the impact of the worldwide debt cap will have on our future tax charge.

These changes have not been substantively enacted at the balance sheet date and therefore have not been reflected in these financial statements.

## 6. Intangible assets

| | Software £m |
|---|---|
| **Non-current** | |
| Cost at 1 April 2007 | 145 |
| Additions | 15 |
| Cost at 31 March 2008 | 160 |
| Additions | 9 |
| Cost at 31 March 2009 | 169 |
| | |
| Amortisation at 1 April 2007 | (80) |
| Amortisation charge for the year | (24) |
| Amortisation at 31 March 2008 | (104) |
| Amortisation charge for the year | (16) |
| Amortisation at 31 March 2009 | (120) |
| **Net book value at 31 March 2009** | **49** |
| Net book value at 31 March 2008 | 56 |

## 7. 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 2007 | 118 | 6,412 | 729 | 106 | 7,365 |
| Additions | 2 | 3 | 781 | (1) | 785 |
| Disposals | - | (13) | - | (32) | (45) |
| Reclassifications | 7 | 241 | (263) | 15 | - |
| Cost at 31 March 2008 | 127 | 6,643 | 1,247 | 88 | 8,105 |
| Additions | 28 | 602 | 223 | 2 | 855 |
| Disposals | - | (73) | - | (1) | (74) |
| Transfers | 21 | - | - | - | 21 |
| Reclassifications | 4 | 4 | (3) | (5) | - |
| Cost at 31 March 2009 | 180 | 7,176 | 1,467 | 84 | 8,907 |
| Depreciation at 1 April 2007 | (13) | (2,488) | - | (92) | (2,593) |
| Depreciation charge for the year | (4) | (206) | - | (10) | (220) |
| Disposals | - | 13 | - | 32 | 45 |
| Depreciation at 31 March 2008 | (17) | (2,681) | - | (70) | (2,768) |
| Depreciation charge for the year | (4) | (192) | - | (9) | (205) |
| Transfers | (8) | - | - | - | (8) |
| Disposals | - | 27 | - | 28 | 55 |
| Depreciation at 31 March 2009 | (29) | (2,846) | - | (51) | (2,926) |
| **Net book value at 31 March 2009** | **151** | **4,330** | **1,467** | **33** | **5,981** |
| Net book value at 31 March 2008 | 110 | 3,962 | 1,247 | 18 | 5,337 |

The net book value of land and buildings comprised:

| | **2009 £m** | 2008 £m |
|---|---|---|
| Freehold | **109** | 102 |
| Long leasehold (over 50 years) | **3** | 3 |
| Short leasehold (under 50 years) | **39** | 5 |
| | **151** | 110 |

The cost of property, plant and equipment at 31 March 2009 included £590m (2008: £519m) relating to interest capitalised.

Included within trade and other payables and other non-current liabilities at 31 March 2009 are contributions to the cost of property, plant and equipment amounting to £6m (2008: £4m) and £209m (2008: £118m) respectively.

Transfers arise from corrections of misallocations of opening balances between the Transmission business and other parts of NGET.

## 8. Derivative financial instruments

For further information and a detailed description of our derivative financial instruments and hedge type designations, refer to note 23. The fair value by designated hedge type can be analysed as follows:

| | 2009 | | | 2008 | | |
|---|---|---|---|---|---|---|
| | Assets £m | Liabilities £m | Total £m | Assets £m | Liabilities £m | Total £m |
| **Fair value hedges** | | | | | | |
| Interest rate swaps | **66** | **-** | **66** | 5 | (5) | - |
| Cross-currency interest rate swaps | **64** | **-** | **64** | - | (3) | (3) |
| | **130** | **-** | **130** | 5 | (8) | (3) |
| **Cash flow hedges** | | | | | | |
| Interest rate swaps | **4** | **(56)** | **(52)** | 20 | (40) | (20) |
| Cross-currency interest rate swaps | **9** | **-** | **9** | 70 | - | 70 |
| | **13** | **(56)** | **(43)** | 90 | (40) | 50 |
| **Derivatives not in a formal hedge relationship** | | | | | | |
| Interest rate swaps | **16** | **(19)** | **(3)** | 1 | (6) | (5) |
| Forward rate agreements | **-** | **(4)** | **(4)** | - | - | - |
| Cross-currency interest rate swaps | **5** | **-** | **5** | - | - | - |
| Foreign exchange forward contracts | **4** | **-** | **4** | - | - | - |
| | **25** | **(23)** | **2** | 1 | (6) | (5) |
| **Total** | **168** | **(79)** | **89** | 96 | (54) | 42 |

The maturity of derivative financial instruments is as follows:

| | 2009 | | | 2008 | | |
|---|---|---|---|---|---|---|
| | Assets £m | Liabilities £m | Total £m | Assets £m | Liabilities £m | Total £m |
| In one year or less | **34** | **(24)** | **10** | 76 | (6) | 70 |
| **Current** | **34** | **(24)** | **10** | 76 | (6) | 70 |
| In more than one year but not more than two years | **5** | **-** | **5** | - | - | - |
| In more than two years but not more than three years | **-** | **-** | **-** | - | - | - |
| In more than three years but not more than four years | **-** | **(11)** | **(11)** | - | - | - |
| In more than four years but not more than five years | **61** | **(1)** | **60** | - | (5) | (5) |
| In more than five years | **68** | **(43)** | **25** | 20 | (43) | (23) |
| **Non-current** | **134** | **(55)** | **79** | 20 | (48) | (28) |
| | **168** | **(79)** | **89** | 96 | (54) | 42 |

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

| | 2009 £m | 2008 £m |
|---|---|---|
| Interest rate swaps | **(1,921)** | (1,981) |
| Cross-currency interest rate swaps | **(698)** | (512) |
| Foreign exchange forward contracts | **(29)** | (4) |
| Forward rate agreements | **(1,978)** | - |
| **Total** | **(4,626)** | (2,497) |

## 9. Inventories

| | 2009 £m | 2008 £m |
|---|---|---|
| Raw materials and consumables | **29** | 12 |
| Work in progress | **-** | 4 |
| | **29** | 16 |

## 10. Trade and other receivables

| | 2009 £m | 2008 £m |
|---|---|---|
| Trade receivables | **9** | 12 |
| Amounts owed by fellow subsidiaries | **20** | 187 |
| Other receivables | **4** | 14 |
| Prepayments and accrued income | **119** | 115 |
| | **152** | 328 |

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 2007 and 31 March 2008 | **1** |
| At 31 March 2009 | **-** |

As at 31 March 2009, trade receivables of £nil (2008: £3m) were past due but not impaired. The ageing analysis of these trade receivables is as follows:

| | 2009 £m | 2008 £m |
|---|---|---|
| Up to 3 months past due | **-** | - |
| 3 to 6 months past due | **-** | - |
| Over 6 months past due | **-** | 3 |
| | **-** | 3 |

For further information about our wholesale credit risk, refer to note 24.

## 11. Financial investments

| | 2009 £m | 2008 £m |
|---|---|---|
| **Current** | | |
| Loans and receivables - amounts due from fellow subsidiaries | **21** | 914 |
| Available-for-sale investments | **339** | - |
| Total financial and other investments | **360** | 914 |

Available-for-sale investments are recorded at fair value. Due to their short maturities, the fair value of loans and receivables approximates to their book value.

## 12. Cash and cash equivalents

| | 2009 £m | 2008 £m |
|---|---|---|
| Cash at bank | **(1)** | 9 |
| Short-term deposits | **388** | - |
| **Cash and cash equivalents excluding bank overdrafts** | **387** | 9 |
| **Bank overdrafts** | **(4)** | - |
| Net cash and cash equivalents | **383** | 9 |

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.

## 13. Borrowings

The following table analyses borrowings, including bank overdrafts:

| | 2009 £m | 2008 £m |
|---|---|---|
| **Current** | | |
| Bank loans | **28** | 1 |
| Bonds | **46** | 517 |
| Borrowings from fellow subsidiaries | **11** | 407 |
| Bank overdrafts | **4** | - |
| | **89** | 925 |
| **Non-current** | | |
| Bank loans | **400** | 398 |
| Bonds | **4,223** | 2,978 |
| | **4,623** | 3,376 |
| **Total borrowings** | **4,712** | 4,301 |

| Total borrowings are repayable as follows: | 2009 £m | 2008 £m |
|---|---|---|
| In one year or less | **89** | 925 |
| In more than one year, but not more than two years | **258** | - |
| In more than two years, but not more than three years | **-** | 248 |
| In more than three years, but not more than four years | **200** | - |
| In more than four years, but not more than five years | **577** | 199 |
| In more than five years other than by instalments | **3,588** | 2,929 |
| | **4,712** | 4,301 |

The fair value of borrowings at 31 March 2009 was £4,367m (2008: £4,187m). 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 2009 was £4,595m (2008: £4,284m).

As at 31 March 2009, NGET had committed credit facilities of £425m (2008: £425m) of which £425m was undrawn (2008: £425m undrawn). These undrawn facilities expire in more than one year but less than two years.

All of the unused facilities at 31 March 2009 and at 31 March 2008 were held as back-up to commercial paper and similar borrowings.

None of NGET's borrowings are secured by charges over its assets.

## 14. Trade and other payables

| | 2009 £m | 2008 £m |
|---|---|---|
| Trade payables | **314** | 377 |
| Amounts owed to fellow subsidiaries | **82** | 203 |
| Social security and other taxes | **31** | 4 |
| Other payables | **26** | 79 |
| Deferred income | **97** | 62 |
| | **550** | 725 |

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

## 15. Other non-current liabilities

| | 2009 £m | 2008 £m |
|---|---|---|
| Other payables | **-** | 15 |
| Deferred income | **208** | 119 |
| | **208** | 134 |

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

## 16. Deferred tax assets and liabilities

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

| | Accelerated tax depreciation £m | Employee share options £m | Pensions £m | Financial instruments £m | Other net temporary differences £m | Total £m |
|---|---|---|---|---|---|---|
| Deferred tax assets at 31 March 2007 | - | (13) | (145) | (5) | (1) | (164) |
| Deferred tax liabilities at 31 March 2007 | 808 | - | - | - | - | 808 |
| At 1 April 2007 | 808 | (13) | (145) | (5) | (1) | 644 |
| Charged/(credited) to income statement | (3) | - | 18 | - | (9) | 6 |
| Charged/(credited) to equity | - | 6 | 14 | (3) | - | 17 |
| At 31 March 2008 | 805 | (7) | (113) | (8) | (10) | 667 |
| Deferred tax assets at 31 March 2008 | - | (7) | (113) | (8) | (10) | (138) |
| Deferred tax liabilities at 31 March 2008 | 805 | - | - | - | - | 805 |
| At 1 April 2008 | 805 | (7) | (113) | (8) | (10) | 667 |
| Charged/(credited) to income statement | 50 | - | 21 | - | 2 | 73 |
| Charged/(credited) to equity | - | 2 | (22) | (9) | - | (29) |
| **At 31 March 2009** | **855** | **(5)** | **(114)** | **(17)** | **(8)** | **711** |
| Deferred tax assets at 31 March 2009 | - | (5) | (114) | (17) | (8) | (144) |
| Deferred tax liabilities at 31 March 2009 | 855 | - | - | - | - | 855 |
| | 855 | (5) | (114) | (17) | (8) | 711 |

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 (2008: £nil).

## 17. Provisions

| | Environmental £m | Other £m | Total provisions £m |
|---|---|---|---|
| At 1 April 2007 | 4 | 4 | 8 |
| Additions | - | 2 | 2 |
| Other movements | - | 7 | 7 |
| Utilised | (2) | - | (2) |
| At 31 March 2008 | 2 | 13 | 15 |
| Additions | - | 5 | 5 |
| Utilised | - | (2) | (2) |
| **At 31 March 2009** | **2** | **16** | **18** |

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

| | **2009 £m** | 2008 £m |
|---|---|---|
| Current | **6** | 4 |
| Non-current | **12** | 11 |
| | **18** | 15 |

**Environmental provision**

The environmental provision is calculated on an undiscounted basis and represents the estimated environmental restoration and remediation costs relating to a number of sites owned and managed by NGET. It is currently estimated that this provision will be utilised within five years.

**Other provisions**

Other provisions include employer liability claims of £7m (2008: £6m). In accordance with insurance industry practice, these estimates are based on experience from previous years and there is therefore no identifiable payment date.

**Other movements**

Other movements represents the reclassification of provisions not included within the Transmission business in previous years.

## 18. Reconciliation of movements in total equity

The Transmission business to which these regulatory accounts relate is not a statutory entity with share capital and reserves. Accordingly the movements on equity are shown in total only.

| | Total equity £m |
|---|---|
| At 1 April 2007 | 326 |
| Total recognised income and expense for the year | 406 |
| Share-based payments | (2) |
| Tax on share-based payments | (3) |
| Transfers (i) | (270) |
| At 31 March 2008 | 457 |
| Total recognised income and expense for the year | 258 |
| Share-based payments | 1 |
| Tax on share-based payments | (1) |
| Transfers (i) | (270) |
| **At 31 March 2009** | **445** |

NGET 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 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 2009 will be continuously transferred to the income statement until the borrowings are repaid (note 13).

The amount of the cash flow hedge reserve due to be released from reserves to the income statement within the next year is £nil, with the remaining amount of £45m due to be released with the same maturity profile as borrowings in note 13.

## 19. Consolidated cash flow statement

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

| | **2009 £m** | 2008 £m |
|---|---|---|
| Movement in cash and cash equivalents | **371** | (426) |
| Increase in financial investments | **(556)** | 516 |
| Increase in borrowings and derivatives | **(200)** | (408) |
| Net interest paid | **155** | 132 |
| Change in net debt resulting from cash flows | **(230)** | (186) |
| Changes in fair value of financial assets and liabilities | **(65)** | (14) |
| Net interest charge | **(237)** | (214) |
| Other non-cash movements | **(8)** | 14 |
| Movement in net debt (net of related derivative financial instruments) in the year | **(540)** | (400) |
| Net debt at start of year | **(3,336)** | (2,936) |
| Net debt (net of related derivative financial instruments) at end of year | **(3,876)** | (3,336) |

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

| | Cash and cash equivalents £m | Bank overdrafts £m | Net cash and cash equivalents £m | Financial investments £m | Borrowings £m | Derivatives £m | Total £m |
|---|---|---|---|---|---|---|---|
| At 1 April 2007 | 461 | (26) | 435 | 376 | (3,712) | (35) | (2,936) |
| Cash flow | (452) | 26 | (426) | 461 | (240) | 19 | (186) |
| Fair value gains and losses | - | - | - | - | (89) | 75 | (14) |
| Interest charges | - | - | - | 55 | (252) | (17) | (214) |
| Other non-cash movements | - | - | - | 22 | (8) | - | 14 |
| At 31 March 2008 | 9 | - | 9 | 914 | (4,301) | 42 | (3,336) |
| Cash flow | 375 | (4) | 371 | (583) | (106) | 88 | (230) |
| Fair value gains and losses | - | - | - | - | (32) | (33) | (65) |
| Interest charges | - | - | - | 27 | (256) | (8) | (237) |
| Other non-cash movements | 3 | - | 3 | 2 | (13) | - | (8) |
| **At 31 March 2009** | **387** | **(4)** | **383** | **360** | **(4,708)** | **89** | **(3,876)** |

# Notes to the consolidated financial statements - supplementary information

## 20. Commitments and contingencies

**(a) Future capital expenditure**

| | 2009 £m | 2008 £m |
|---|---|---|
| Contracted for but not provided | **763** | 482 |

**(b) Lease commitments**

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

| | 2009 £m | 2008 £m |
|---|---|---|
| Amounts due: | | |
| In one year or less | **7** | 6 |
| In more than one year, but not more than two years | **6** | 6 |
| In more than two years, but not more than three years | **5** | 5 |
| In more than three years, but not more than four years | **4** | 4 |
| In more than four years, but not more than five years | **5** | 5 |
| In more than five years | **36** | 40 |
| | **63** | 66 |

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 £1m (2008: £3m).

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

The value of other commitments and guarantees at 31 March 2009 amounted to £40m (2008: £19m) and comprised the following:

(i) Guarantees in respect of a former associate amounting to £14m (2008: £14m). These are open ended.

(ii) Guarantees in the normal course of business and entered into on normal commercial terms of £26m (2008: £5m). These guarantees run for various lengths of time.

## 21. 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 plc, a joint venture and a pension plan, are in the normal course of business and are summarised below.

| | Parent | | Other related parties | | Total | |
|---|---|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 | **2009** | 2008 |
| | **£m** | £m | **£m** | £m | **£m** | £m |
| Income: | | | | | | |
| Goods and services supplied | **-** | - | **11** | 4 | **11** | 4 |
| Interest received on advances to fellow subsidiaries | **3** | 7 | **27** | 30 | **30** | 37 |
| | **3** | 7 | **38** | 34 | **41** | 41 |
| Expenditure: | | | | | | |
| Services received | **-** | - | **(19)** | (24) | **(19)** | (24) |
| Corporate services received | **-** | - | **(12)** | (11) | **(12)** | (11) |
| Charges in respect of share-based payments | **-** | - | **(2)** | (3) | **(2)** | (3) |
| Interest paid on borrowings from fellow subsidiaries | **(3)** | - | **(23)** | (17) | **(26)** | (17) |
| | **(3)** | - | **(56)** | (55) | **(59)** | (55) |
| Outstanding balances at 31 March in respect of income, expenditure and settlement of corporation tax: | | | | | | |
| Amounts receivable | **-** | - | **20** | 196 | **20** | 196 |
| Amounts payable | **-** | - | **(83)** | (203) | **(83)** | (203) |
| Advances to fellow subsidiaries (amounts due within one year): | | | | | | |
| At 1 April | **71** | 283 | **844** | 113 | **915** | 396 |
| Advances | **-** | - | **-** | 730 | **-** | 730 |
| Repayments | **(71)** | (212) | **(823)** | - | **(894)** | (212) |
| At 31 March | **-** | 71 | **21** | 843 | **21** | 914 |
| Borrowings payable to fellow subsidiaries (amounts due within one year): | | | | | | |
| At 1 April | **-** | - | **(408)** | (194) | **(408)** | (194) |
| Advances | **-** | - | **(9)** | (221) | **(9)** | (221) |
| Repayments | **-** | - | **406** | 8 | **406** | 8 |
| At 31 March | **-** | - | **(11)** | (407) | **(11)** | (407) |

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

No amounts have been provided at 31 March 2009 (2008: £nil) and no expense recognised during the year (2008: £nil) in respect of bad or doubtful debts for related party transactions.

Details of key management compensation are provided in note 1(c).

## 22. Actuarial information on pensions

The Electricity Supply Pension Scheme is a funded scheme which is divided into two sections, one of which is National Grid's section. This section of the scheme provides final salary defined benefits and was closed to new entrants on 1 April 2006.

The scheme is funded with assets held in a separate trustee administered fund. It is subject to independent actuarial valuations 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 the employees and proceeds from the scheme's assets, are expected to be sufficient to fund the benefits payable under the scheme.

The latest full actuarial valuation as at 31 March 2007 has been carried out by Hewitt Associates Limited. The aggregate market value of the scheme’s assets at that date was £1,345m and the value of the assets represented 77% of the actuarial value of benefits due to members, calculated on the basis of pensionable earnings and service at 31 March 2007 on an ongoing basis and allowing for projected increases in pensionable earnings. There was a funding deficit of £405m (£284m net of tax) on the valuation date in the light of which NGET agreed a recovery plan with the trustees.

The actuarial valuation showed that, based on long-term financial assumptions, the contribution rate required to meet future benefit accrual was 26.5% of pensionable earnings (20.5% employers and 6% employees). This contribution rate will be reviewed as part of the next full actuarial valuation due 31 March 2010.

Following the 2007 actuarial valuation, NGET and the trustees agreed a recovery plan which will see the remaining deficit paid off by March 2017. NGET paid deficit repair contributions of £90m (£63m net of tax) in the year to 31 March 2009 and a further payment of £90m (£60m net of tax) in April 2009.

As part of the 2007 valuation, National Grid arranged for banks to provide the trustees with letters of credit, including triggers to bring forward payment of the outstanding deficit and interest. The conditions under which payment of the outstanding deficit would be made are if NGET ceases to hold the licence granted under the Electricity Act 1989 or NGET's credit rating by two out of three specified agencies falls below an agreed level for a period of 40 days.

### Asset allocations and actuarial assumptions

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

| | **2009** | 2008 | 2007 |
|---|---|---|---|
| | **%** | % | % |
| Equities | **47.6** | 55.5 | 61.2 |
| Corporate bonds | **13.0** | 9.0 | 7.6 |
| Gilts | **33.0** | 28.6 | 24.2 |
| Property | **4.8** | 5.8 | 6.6 |
| Other | **1.6** | 1.1 | 0.4 |
| Total | **100.0** | 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 plan. The expected real returns on specific asset 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 principal actuarial assumptions used were:

| | **2009** | 2008 | 2007 |
|---|---|---|---|
| | **%** | % | % |
| Discount rate (i) | **6.8** | 6.6 | 5.4 |
| Expected return on plan assets | **6.3** | 6.9 | 6.8 |
| Rate of increase in salaries (ii) | **3.9** | 4.7 | 4.2 |
| Rate of increase in pensions in payment and deferment | **2.8** | 3.8 | 3.3 |
| Rate of increase in Retail Prices Index | **2.9** | 3.7 | 3.2 |

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

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

## 22. Actuarial information on pensions continued

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

| | **2009 years** | 2008 years |
|---|---|---|
| **Today:** | | |
| Males | **22.3** | 22.1 |
| Females | **23.7** | 23.6 |
| **In 20 years:** | | |
| Males | **24.7** | 24.6 |
| Females | **26.5** | 26.4 |

Sensitivities analysed - all other assumptions held constant:

| | Change in in pension obligation | | Change in in annual pension cost | |
|---|---|---|---|---|
| | **2009 £m** | 2008 £m | **2009 £m** | 2008 £m |
| 0.1% increase in discount rate | **20** | 25 | **-** | 1 |
| 0.5% increase in long-term rate of increase in salaries | **19** | 24 | **1** | 1 |
| Increase in one year to life expectations at age 60 | **37** | 45 | **-** | - |

The history of experience adjustments for NGET's section of the scheme is as follows:

| | **2009 £m** | 2008 £m | 2007 £m | 2006 £m | 2005 £m |
|---|---|---|---|---|---|
| **Details of experience gains/(losses)** | | | | | |
| Present value of funded and unfunded obligations | **(1,553)** | (1,730) | (1,824) | (1,724) | (1,584) |
| Fair value of plan assets | **1,145** | 1,321 | 1,336 | 1,334 | 1,161 |
| | **(408)** | (409) | (488) | (390) | (423) |
| Difference between expected and actual return on plan assets | **(301)** | (77) | (25) | 168 | 38 |
| Experience losses on plan liabilities | **(19)** | (30) | (4) | (11) | (20) |
| Actuarial gains/(losses) on plan liabilities | **224** | 128 | (67) | (125) | 2 |

## 23. 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, and equity or other indices. Derivatives enable their users to alter exposure to market or credit risks. NGET uses derivatives to manage its 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 assets and liabilities.

Hedging policies using derivative financial instruments are further explained in note 24. 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 life of the hedged item.

**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 a fixed sterling rate. Interest rate and cross-currency swaps are maintained and designated as cash flow hedges, where they qualify, to manage this exposure. Fair value changes on designated cash flow hedges are initially recognised directly in the cash flow hedge reserve, as gains or losses recognised in equity. 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**

NGET's 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.

## 24. Financial risk

NGET's activities expose it 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 financing activities is carried out by a central treasury department under policies approved by the Boards of Directors of National Grid plc and NGET. This department identifies, evaluates and hedges financial risks in close co-operation with the operating units. The Board 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 page 18 of the Operating and Financial Review.

# 24. Financial risk continued

## (a) Market risk

*(i) Foreign exchange risk*

NGET 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, NGET uses foreign exchange forwards to manage foreign exchange transaction exposure. NGET's 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, a percentage of the foreign currency flows are generally covered depending on the level of agreed probability for those cash flows.

During 2009 and 2008, derivative financial instruments were used to manage exchange risk as follows:

| | **2009** | | | | |
|---|---|---|---|---|---|
| | **Sterling £m** | **Euro £m** | **US dollar £m** | **Other £m** | **Total £m** |
| Cash and cash equivalents | **387** | **-** | **-** | **-** | **387** |
| Financial investments | **360** | **-** | **-** | **-** | **360** |
| Borrowings | **(3,859)** | **(706)** | **-** | **(147)** | **(4,712)** |
| **Pre-derivative position** | **(3,113)** | **(706)** | **-** | **(147)** | **(3,967)** |
| Derivative effect | **(764)** | **702** | **3** | **147** | **89** |
| **Net debt position** | **(3,875)** | **(4)** | **3** | **-** | **(3,876)** |

| | 2008 | | | | |
|---|---|---|---|---|---|
| | Sterling £m | Euro £m | US dollar £m | Other £m | Total £m |
| Cash and cash equivalents | 9 | - | - | - | 9 |
| Financial investments | 914 | - | - | - | 914 |
| Borrowings | (3,719) | (483) | (1) | (98) | (4,301) |
| Pre-derivative position | (2,796) | (483) | (1) | (98) | (3,378) |
| Derivative effect | (543) | 483 | 4 | 98 | 42 |
| Net debt position | (3,339) | - | 3 | - | (3,336) |

The currency exposure on other financial instruments is as follows:

| | **2009** | | | | 2008 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Sterling £m** | **Euro £m** | **US dollar £m** | **Total £m** | Sterling £m | Euro £m | US dollar £m | Total £m |
| Trade and other receivables | **33** | **-** | **-** | **33** | 177 | 24 | 12 | 213 |
| Trade and other payables | **(422)** | **-** | **-** | **(422)** | (659) | - | - | (659) |
| Other non-current liabilities | **-** | **-** | **-** | **-** | (15) | - | - | (15) |
| | **(389)** | **-** | **-** | **(389)** | (497) | 24 | 12 | (461) |

*(ii) Cash flow and fair value interest rate risk*

Interest rate risk arises from NGET's borrowings. Borrowings issued at variable rates expose NGET to cash flow interest rate risk. Borrowings issued at fixed rates expose NGET to fair value interest rate risk. The interest rate risk management policy as further explained on page 18 is to minimise the finance costs (being interest costs and changes in the market value of debt), subject to certain constraints. Some of the borrowings issued are index-linked, that is their cost is linked to changes in the UK Retail Prices Index (RPI). NGET believes that these borrowings provide a good hedge for revenues and our regulatory asset values that are also RPI-linked.

Interest rate risk arising from financial investments is primarily variable.

# 24. Financial risk continued

## (a) Market risk continued

*(ii) Cash flow and fair value interest rate risk continued*

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:

| | 2009 £m | 2008 £m |
|---|---|---|
| **Fixed interest rate borrowings** | | |
| In one year or less | **61** | 911 |
| In more than one year but not more than two years | **258** | - |
| In more than two years but not more than three years | **-** | 248 |
| In more than three years but not more than four years | **-** | - |
| In more than four years but not more than five years | **577** | - |
| In more than five years | **1,373** | 890 |
| | **2,269** | 2,049 |
| **Floating interest rate borrowings (including RPI)** | **2,443** | 2,252 |
| **Non-interest bearing borrowings** | **1** | - |
| **Total borrowings** | **4,712** | 4,301 |

During 2009 and 2008, net debt was managed using derivative instruments to hedge interest rate risk as follows:

| 2009 | Fixed rate £m | Floating rate £m | RPI(i) £m | Other(ii) £m | Total £m |
|---|---|---|---|---|---|
| Cash and cash equivalents | **-** | **387** | **-** | **-** | **387** |
| Financial investments | **-** | **358** | **-** | **2** | **360** |
| Borrowings | **(2,269)** | **(415)** | **(2,027)** | **(1)** | **(4,712)** |
| **Pre-derivative position** | **(2,269)** | **330** | **(2,027)** | **1** | **(3,965)** |
| Derivative effect | **243** | **(253)** | **96** | **3** | **89** |
| **Net debt position** | **(2,025)** | **77** | **(1,931)** | **4** | **(3,876)** |

| 2008 | Fixed rate £m | Floating rate £m | RPI(i) £m | Other(ii) £m | Total £m |
|---|---|---|---|---|---|
| Cash and cash equivalents | - | 9 | - | - | 9 |
| Financial investments | - | 884 | - | 30 | 914 |
| Borrowings | (2,049) | (402) | (1,850) | - | (4,301) |
| Pre-derivative position | (2,049) | 491 | (1,850) | 30 | (3,378) |
| Derivative effect | 337 | (291) | (4) | - | 42 |
| Net debt position | (1,712) | 200 | (1,854) | 30 | (3,336) |

(i) The post-derivative impact represents financial instruments linked to UK RPI.

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

(iii) The post derivative impact includes 2009/10 maturing short dated derivative contracts.

## 24. Financial risk continued

### (b) Credit risk

Credit risk is managed on a portfolio basis for National Grid 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. NGET's limits are managed by the central treasury department of National Grid, as explained under treasury policies on page 19.

As at 31 March 2009 and 2008, NGET had had a number of exposures to individual counterparties. In accordance with NGET's 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. NGET does not expect any significant losses from non-performance by these counterparties.

The counterparty exposure under derivative financial contracts as shown in note 8 was £168m (2008: £96m); after netting agreements it was £125m (2008: £70m).

**Wholesale and retail credit risk**

NGET's principal commercial exposure is governed by the credit rules within the regulated Connection and Use of System Code. This lays down the level of credit relative to the regulatory asset value for each credit rating. NGET has no retail credit risk. Management does not expect any significant losses of receivables that have not been provided for as shown in note 10.

### (c) Liquidity analysis

NGET manages its 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 2009** | **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 | **(38)** | **(250)** | **-** | **(4,306)** | **(4,594)** |
| Interest payments on borrowings (i) | **(185)** | **(185)** | **(184)** | **(3,127)** | **(3,681)** |
| Other non-interest bearing liabilities | **(350)** | **-** | **-** | **-** | **(350)** |
| **Derivative financial liabilities** | | | | | |
| Derivative contracts - receipts | **47** | **56** | **30** | **221** | **354** |
| Derivative contracts - payments | **(30)** | **(24)** | **(26)** | **(203)** | **(283)** |
| **Total at 31 March 2009** | **(556)** | **(403)** | **(180)** | **(7,415)** | **(8,554)** |

| 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 | (882) | - | (249) | (3,153) | (4,284) |
| Interest payments on borrowings (i) | (139) | (129) | (128) | (2,523) | (2,919) |
| Other non-interest bearing liabilities | (670) | (15) | - | - | (685) |
| **Derivative financial liabilities** | | | | | |
| Derivative contracts - receipts | 78 | 8 | 8 | 851 | 945 |
| Derivative contracts - payments | (15) | (14) | (14) | (1,212) | (1,255) |
| Total at 31 March 2008 | (1,628) | (150) | (383) | (6,037) | (8,198) |

(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. Payments are included on the basis of the earliest date on which NGET can be required to settle.

## 24. 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 pension obligations and 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 2009 and 31 March 2008, 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, 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.

| | **2009** | | 2008 | |
|---|---|---|---|---|
| | **Income statement -/+ £m** | **Equity -/+ £m** | Income statement -/+ £m | Equity -/+ £m |
| UK Retail Prices Index +/- 0.50% | **7** | **-** | 6 | - |
| UK interest rates +/- 0.50% | **3** | **18** | 1 | 9 |

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

### (e) Capital and risk management

NGET'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 balance sheet efficiency is gearing calculated as net debt expressed as a percentage of regulatory asset value. The gearing ratio at 31 March 2009 was 58% compared to 52% at 31 March 2008. NGET regularly reviews and maintains or adjusts the capital structure as appropriate in order to manage the level of gearing.

NGET's licence and some of its bank loan agreements impose lower limits for the long-term credit ratings that NGET must hold. These requirements are monitored on a regular basis in order to ensure compliance.

## 25. Share options and reward plans

National Grid operates three principal forms of share option and award plans in which NGET's employees and Directors participate. These are an employee Sharesave scheme, a Performance Share Plan and the Deferred Share Plan. In addition there are two historical plans under which awards are outstanding, but no further awards will be granted. These are the Executive Plan and the Share Matching Plan. Information for these plans is only available for NGET as a whole and not in respect of the business and activities included in these regulatory statements. The information in respect of NGET can be found in the NGET 2009 Annual Report and Accounts on page 65.

## 26. Ultimate parent company

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

## 27. Subsidiary undertakings

The principal subsidiary undertakings included in the consolidated financial statements are NG Leasing Limited, whose principal activity is vehicle leasing, and NGET Finance (No 1) plc, a finance company. Both these companies are wholly owned and incorporated in Great Britain.

NGET does not consolidate its wholly owned subsidiary Elexon Limited, which is the electricity market Balancing and Settlement Code company for Great Britain, as it does not have control over this subsidiary.

## 28. Charges and apportionments
## Statement required by the Transmission Licence, Condition B1, Part B, paragraph 3(b)(viii)(aa) and (bb)

***In accordance with the Transmission Licence, Condition B1, Part D, paragraph 10, note 28 does not form part of the published regulatory accounting statements.***

## 28. Charges and apportionments continued
## Statement required by the Transmission Licence, Condition B1, Part B, paragraph 3(b)(viii)(cc)

***In accordance with the Transmission Licence, Condition B1, Part D, paragraph 10, note 28 does not form part of the published regulatory accounting statements.***

## 28. Charges and apportionments continued
## Statement required by the Transmission Licence, Condition B1, Part B, paragraph 3(b)(viii)(cc) continued

***In accordance with the Transmission Licence, Condition B1, Part D, paragraph 10, note 28 does not form part of the published regulatory accounting statements.***

# Glossary and definitions

References to the 'Company' and the use of the abbreviation 'NGET' refer to National Grid Electricity Transmssion plc, or to National Grid Electricity Transmission plc and its subsidiaries collectively, depending on context.

References to the Transmission business refer to the regulated business as defined by the Electricity Transmission Licence.

References to the Electricity Transmission Licence refer to the licence granted under the Electricity Act 1989.

**Other definitions**

**BETTA**
The British Electricity Trading and Transmission Arrangements, being the regulations that govern our role as operator of the electricity networks in Great Britain, together with those of other market participants.

**BSIS**
The Balancing Services Incentive Scheme, an incentive arrangement applicable to our electricity transmission arrangements.

**FRS**
UK Financial Reporting Standard.

**GW**
Gigawatt, $10^9$ watts.

**GWh**
Gigawatt hours.

**HSE**
Health and Safety Executive.

**IAS**
International Accounting Standard.

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

**IFRS**
International Financial Reporting Standard.

**KPI**
Key Performance Indicator.

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

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

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

**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.

National Grid Electricity Transmission plc
1-3 Strand, London WC2N 5EH, United Kingdom
Registered in England and Wales No. 2366977