

Boston Gas Company

d/b/a National Grid

Financial Statements

For the years ended March 31, 2017, 2016 and 2015

BOSTON GAS COMPANY

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Report of Independent Auditors

To the Board of Directors of
Boston Gas Company

We have audited the accompanying financial statements of Boston Gas Company, which comprise the balance sheets and statements of capitalization as of March 31, 2017 and 2016, and the related statements of income, comprehensive income, cash flows, and changes in shareholders' equity for each of the three years in the period ended March 31, 2017.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Boston Gas Company as of March 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended March 31, 2017 in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

July 21, 2017

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BOSTON GAS COMPANY
STATEMENTS OF INCOME
(in thousands of dollars)

	Years Ended March 31,		
	2017	2016	2015
Operating revenues	\$ 1,066,378	\$ 985,466	\$ 1,325,541
Operating expenses:			
Purchased gas	349,144	310,165	579,711
Operations and maintenance	371,801	346,721	455,619
Depreciation	148,941	139,400	131,408
Other taxes	55,210	53,454	57,491
Total operating expenses	925,096	849,740	1,224,229
Operating income	141,282	135,726	101,312
Other income and (deductions):			
Interest on long-term debt	(31,479)	(32,657)	(32,999)
Other interest, including affiliate interest	5,407	6,235	(4,835)
Other deductions, net	(6,609)	(1,658)	(3,438)
Total other deductions, net	(32,681)	(28,080)	(41,272)
Income before income taxes	108,601	107,646	60,040
Income tax expense	43,998	43,899	24,545
Net income	\$ 64,603	\$ 63,747	\$ 35,495

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

BOSTON GAS COMPANY
STATEMENTS OF COMPREHENSIVE INCOME
(in thousands of dollars)

	Years Ended March 31,		
	2017	2016	2015
Net income	\$ 64,603	\$ 63,747	\$ 35,495
Other comprehensive income, net of taxes:			
Unrealized gains (losses) on securities	5	(14)	7
Total other comprehensive income (loss)	5	(14)	7
Comprehensive income	\$ 64,608	\$ 63,733	\$ 35,502
Related tax (expense) benefit:			
Unrealized (gains) losses on securities	(3)	9	\$ (5)
Total tax (expense) benefit	\$ (3)	\$ 9	\$ (5)

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

BOSTON GAS COMPANY
STATEMENTS OF CASH FLOWS
(in thousands of dollars)

	Years Ended March 31,		
	2017	2016	2015
Operating activities:			
Net income	\$ 64,603	\$ 63,747	\$ 35,495
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	148,941	139,400	131,408
Provision for deferred income taxes	36,815	41,683	4,243
Bad debt expense	20,564	20,933	33,109
Net postretirement benefits expense	3,234	2,318	(8,648)
Net environmental remediation payments	(6,268)	(4,824)	(3,676)
Changes in operating assets and liabilities:			
Accounts receivable and other receivable, net, and unbilled revenues	(81,804)	116,019	(34,182)
Inventory	9,926	(6,904)	(10,313)
Regulatory assets and liabilities, net	14,314	(47,288)	64,344
Derivative instruments	(2,772)	(9,097)	7,063
Prepaid and accrued taxes	(8,350)	(18,764)	7,273
Accounts payable and other liabilities	15,599	(22,673)	(57,102)
Other, net	(1,571)	841	160
Net cash provided by operating activities	<u>213,231</u>	<u>275,391</u>	<u>169,174</u>
Investing activities:			
Capital expenditures	(424,457)	(321,163)	(299,758)
Cost of removal	(31,950)	(22,325)	(20,126)
Net cash used in investing activities	<u>(456,407)</u>	<u>(343,488)</u>	<u>(319,884)</u>
Financing activities:			
Payments on long-term debt	(10,000)	(10,000)	(2,000)
Affiliated money pool borrowing and receivables/payables, net	253,733	67,721	155,210
Parent loss tax allocation	-	12,774	-
Net cash provided by financing activities	<u>243,733</u>	<u>70,495</u>	<u>153,210</u>
Net increase in cash and cash equivalents	557	2,398	2,500
Cash and cash equivalents, beginning of year	4,898	2,500	-
Cash and cash equivalents, end of year	<u>\$ 5,455</u>	<u>\$ 4,898</u>	<u>\$ 2,500</u>
Supplemental disclosures:			
Interest paid	(31,558)	(32,721)	(36,539)
Income taxes refunded (paid)	202	(6,381)	(6,629)
Significant non-cash items:			
Capital-related accruals included in accounts payable	26,253	22,984	2,114

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

BOSTON GAS COMPANY
BALANCE SHEETS
(in thousands of dollars)

	March 31,	
	2017	2016
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 5,455	\$ 4,898
Accounts receivable	248,101	207,450
Allowance for doubtful accounts	(47,092)	(44,477)
Accounts receivable from affiliates	1,981	1,984
Unbilled revenues	77,329	54,125
Inventory	47,640	57,566
Regulatory assets	110,211	130,719
Derivative instruments	3,425	605
Other	7,532	288
Total current assets	454,582	413,158
Property, plant and equipment, net	3,088,771	2,745,520
Other non-current assets:		
Regulatory assets	138,707	162,218
Accounts receivable from affiliates - deferred	2,605	3,219
Goodwill	396,322	396,322
Derivative instruments	-	23
Other	664	688
Total other non-current assets	538,298	562,470
Total assets	\$ 4,081,651	\$ 3,721,148

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

BOSTON GAS COMPANY
BALANCE SHEETS
(in thousands of dollars)

	March 31,	
	2017	2016
LIABILITIES AND CAPITALIZATION		
Current liabilities:		
Accounts payable	\$ 58,705	\$ 57,000
Accounts payable to affiliates	70,713	43,124
Current portion of long-term debt	8,000	10,000
Taxes accrued	897	650
Customer deposits	1,833	4,438
Interest accrued	7,304	7,891
Regulatory liabilities	37,221	40,671
Intercompany money pool	547,864	321,723
Derivative instruments	1,183	4,059
Other	18,427	16,128
Total current liabilities	752,147	505,684
Other non-current liabilities:		
Regulatory liabilities	611,181	578,374
Asset retirement obligations	15,012	14,311
Deferred income tax liabilities, net	528,493	485,451
Postretirement benefits	51,611	86,024
Environmental remediation costs	40,371	35,898
Derivative instruments	3,808	907
Other	46,397	38,748
Total other non-current liabilities	1,296,873	1,239,713
Capitalization:		
Shareholders' equity	1,433,957	1,369,349
Long-term debt	598,674	606,402
Total capitalization	2,032,631	1,975,751
Total liabilities and capitalization	\$ 4,081,651	\$ 3,721,148

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

BOSTON GAS COMPANY
STATEMENTS OF CAPITALIZATION
(in thousands of dollars)

			March 31,	
			2017	2016
Total shareholders' equity			\$ 1,433,957	\$ 1,369,349
Long-term debt:	Interest Rate	Maturity Date		
Senior Note	4.49%	February 15, 2042	500,000	500,000
Medium Term Notes ("MTN")				
MTN Series 1994 B	6.93%	April 1, 2016	-	10,000
MTN Series 1992 A	8.33%	July 10, 2017	8,000	8,000
MTN Series 1992 A	8.33%	July 10, 2018	10,000	10,000
MTN Series 1994 B	6.93%	January 15, 2019	10,000	10,000
MTN Series 1989 A	8.97%	December 15, 2019	7,000	7,000
MTN Series 1990 A	9.75%	December 1, 2020	5,000	5,000
MTN Series 1990 A	9.05%	September 1, 2021	15,000	15,000
MTN Series 1992 A	8.33%	July 5, 2022	10,000	10,000
MTN Series 1995 C	6.95%	December 1, 2023	10,000	10,000
MTN Series 1994 B	6.98%	January 15, 2024	6,000	6,000
MTN Series 1995 C	6.95%	December 1, 2024	5,000	5,000
MTN Series 1995 C	7.25%	October 1, 2025	20,000	20,000
MTN Series 1995 C	7.25%	October 1, 2025	5,000	5,000
Total debt			611,000	621,000
Current portion of long-term debt			(8,000)	(10,000)
Unamortized debt premium and issuance costs			(4,326)	(4,598)
Long-term debt			598,674	606,402
Total capitalization			\$ 2,032,631	\$ 1,975,751

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

BOSTON GAS COMPANY
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(in thousands of dollars)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)			Retained Earnings	Total
			Unrealized Gain (Loss) on Available- For-Sale Securities	Other Comprehensive Income (Loss)	Total Accumulated Other Comprehensive Income (Loss)		
Balance as of March 31, 2014	\$ 51,418	\$ 962,670	\$ 74	\$ 74	\$ 243,178	\$ 1,257,340	
Net income	-	-	-	-	35,495	35,495	
Other comprehensive income (loss):							
Unrealized gains on securities, net of \$5 tax expense	-	-	7	7	-	7	
Change in pension and other postretirement	-	-	-	-	-	-	
Total comprehensive income						<u>35,502</u>	
Balance as of March 31, 2015	\$ 51,418	\$ 962,670	\$ 81	\$ 81	\$ 278,673	\$ 1,292,842	
Net income	-	-	-	-	63,747	63,747	
Other comprehensive loss:							
Unrealized losses on securities, net of \$9 tax benefit	-	-	(14)	(14)	-	(14)	
Total comprehensive income						<u>63,733</u>	
Parent loss tax allocation	-	12,774	-	-	-	12,774	
Balance as of March 31, 2016	\$ 51,418	\$ 975,444	\$ 67	\$ 67	\$ 342,420	\$ 1,369,349	
Net income	-	-	-	-	64,603	64,603	
Other comprehensive loss:							
Unrealized gains on securities, net of \$3 tax expense	-	-	5	5	-	5	
Total comprehensive income						<u>64,608</u>	
Balance as of March 31, 2017	\$ 51,418	\$ 975,444	\$ 72	\$ 72	\$ 407,023	\$ 1,433,957	

The Company had 514,184 shares of common stock authorized, issued and outstanding, with a par value of \$100 per share at March 31, 2017 and 2016.

BOSTON GAS COMPANY
NOTES TO THE FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Boston Gas Company d/b/a National Grid ("the Company") is a gas distribution company engaged in the transportation and sale of natural gas to approximately 683,000 residential, commercial and industrial customers in the City of Boston, Essex County, and other communities in eastern and central Massachusetts.

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

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

The Company has evaluated subsequent events and transactions through July 21, 2017, the date of issuance of these financial statements, and concluded that there were no events or transactions that require adjustment to, or disclosure in, the financial statements as of and for the year ended March 31, 2017.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

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

Regulatory Accounting

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

Revenue Recognition

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

With respect to base distribution rates, the DPU has approved a Revenue Decoupling Mechanism ("RDM"), which requires the Company to adjust its base rates semi-annually to reflect the over or under recovery of the Company's allowed revenues per customer from the prior peak (November – April) and off-peak (May – October) seasons.

The Company's tariff includes a cost of gas adjustment factor ("CGAF") which requires the Company to adjust firm gas sales rates semi-annually or monthly, in order to track changes in the cost of gas and other operating expenses. The CGAF includes a prior period reconciliation for the over or under recovery of actual costs and collections incurred during the prior peak and off peak seasons.

Other Taxes

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

Income Taxes

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

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

NGNA files consolidated federal tax returns including all of the activities of its subsidiaries. Each subsidiary determines its current and deferred taxes based on the separate return method, modified by benefits-for-loss allocation pursuant to a tax sharing agreement between NGNA and its subsidiaries. To the extent that the consolidated return group settles cash differently than the amount reported as realized under the benefit-for-loss allocation, the difference is accounted for as either a capital contribution or as a distribution. The Company did not record a difference this year since it was in a taxable loss position.

Cash and Cash Equivalents

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

Accounts Receivable and Allowance for Doubtful Accounts

The Company recognizes an allowance for doubtful accounts to record accounts receivable at estimated net realizable value. The allowance is determined based on a variety of factors including, for each type of receivable, applying an estimated reserve percentage to each aging category, taking into account historical collection and write-off experience and management's assessment of collectability from individual customers as appropriate. The collectability of receivables is continuously assessed and, if circumstances change, the allowance is adjusted accordingly. Receivable balances are written off against the allowance for doubtful accounts when the accounts are disconnected and/or terminated and the balances are deemed to be uncollectible.

Inventory

Inventory is comprised of materials and supplies as well as gas in storage. Materials and supplies are stated at the lower of weighted average cost or market and are expensed or capitalized as used. The Company's policy is to write-off obsolete inventory; there were no material write-offs of obsolete inventory for the years ended March 31, 2017, 2016 or 2015.

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

The Company had materials and supplies of \$16.7 million and \$18.6 million and gas in storage of \$30.9 million and \$39 million at March 31, 2017 and 2016, respectively.

Derivative Instruments

The Company uses derivative instruments (including option and swap contracts) to manage commodity price risk. All derivative instruments are recorded on the balance sheet at their fair value. All commodity costs, including the impact of derivative instruments, are passed on to customers through the Company's gas cost adjustment mechanisms. Therefore, gains or losses on the settlement of these contracts are initially deferred and then refunded to, or collected from, customers consistent with regulatory requirements.

The Company's accounting policy is to not offset fair value amounts recognized for derivative instruments and related cash collateral receivable or payable with the same counterparty under a master netting agreement, and to record and present the fair value of the derivative instrument on a gross basis, with related cash collateral recorded within restricted cash and special deposits on the balance sheet. There was no related cash collateral as of March 31, 2017 or 2016.

Natural Gas Long-Term Arrangements

The Company enters into long-term gas contracts to procure commodity to serve its gas customers. Those contracts include Asset Management Agreements, Baseload, and Peaking gas contracts. The Company evaluates whether such agreements are derivative instruments or executory contracts and applies the appropriate accounting treatment.

Fair Value Measurements

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

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

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

Property, Plant and Equipment

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

Depreciation is computed over the estimated useful life of the asset using the composite straight-line method. Depreciation studies are conducted periodically to update the composite rates and are approved by the DPU. The average composite rates for the years ended March 31, 2017, 2016 and 2015 were 3.9%, 4.2% and 4.4%, respectively.

Depreciation expense includes a component for estimated future cost of removal, which is recovered through rates charged to customers. Any difference in cumulative costs recovered and costs incurred is recognized as a regulatory liability. When property, plant and equipment is retired, the original cost, less salvage, is charged to accumulated depreciation, and the related cost of removal is removed from the associated regulatory liability. The Company had cumulative costs recovered in excess of costs incurred of \$608.2 million and \$575.7 million at March 31, 2017 and 2016, respectively.

Allowance for Funds Used During Construction

In accordance with applicable accounting guidance, the Company records AFUDC, which represents the debt and equity costs of financing the construction of new property, plant and equipment. AFUDC equity is reported in the statements of income as non-cash income in other deductions, net, and AFUDC debt is reported as a non-cash offset to other interest, including affiliate interest. After construction is completed, the Company is permitted to recover these costs through their inclusion in rate base and corresponding depreciation expense. The Company had no recorded equity AFUDC for the years ended March 31, 2017 and 2016, and \$0.6 million for year ended 2015. The Company recorded \$1.0 million, \$0.5 million and \$0.2 million of AFUDC related to debt for the years ended March 31, 2017, 2016 and 2015, respectively. The average AFUDC rates for the years ended March 31, 2017, 2016 and 2015 were 1%, 0.7% and 0.3%, respectively.

Impairment of Long-Lived Assets

The Company tests the impairment of long-lived assets annually or when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. The recoverability of an asset is determined by comparing its carrying value to the future undiscounted cash flows that the asset is expected to generate. If the comparison indicates that the carrying value is not recoverable, an impairment loss is recognized for the excess of the carrying value over the estimated fair value. For the years ended March 31, 2017, 2016, and 2015, there were no impairment losses recognized for long-lived assets.

Goodwill

The Company tests goodwill for impairment annually on January 1, and when events occur or circumstances change that would more likely than not reduce the fair value of the Company below its carrying amount. Goodwill is tested for impairment using a two-step approach. The first step compares the estimated fair value of the Company with its carrying value, including goodwill. If the estimated fair value exceeds the carrying value, then goodwill is considered not impaired. If the carrying value exceeds the estimated fair value, then a second step is performed to determine the implied fair value of goodwill. If the carrying value of goodwill exceeds its implied fair value, then an impairment charge equal to the difference is recorded.

The fair value of the Company was calculated in the annual goodwill impairment test for the year ended March 31, 2017 utilizing both income and market approaches. The Company uses a 50% weighting for each valuation methodology, as it believes that each methodology provides equally valuable information. Based on the resulting fair value from the annual analyses, the Company determined that no adjustment of the goodwill carrying value was required at March 31, 2017, 2016 or 2015.

Available-For-Sale Securities

The Company provides certain executives with nonqualified retirement and deferred compensation benefits which have been partially secured through separate fund arrangements. As a result, the Company holds available-for-sale securities that include equities, municipal bonds, and corporate bonds. These investments are recorded at fair value and are included in other non-current assets on the balance sheet. Changes in the fair value of these assets are recorded within other comprehensive income.

Asset Retirement Obligations

Asset retirement obligations are recognized for legal obligations associated with the retirement of property, plant and equipment, primarily associated with the Company's gas distribution facilities. Asset retirement obligations are recorded at fair value in the period in which the obligation is incurred, if the fair value can be reasonably estimated. In the period in which new asset retirement obligations, or changes to the timing or amount of existing retirement obligations are recorded, the associated asset retirement costs are capitalized as part of the carrying amount of the related long-lived asset. In each subsequent period the asset retirement obligation is accreted to its present value. The Company applies regulatory accounting guidance and both the depreciation and accretion costs associated with asset retirement obligation are recorded as increases to regulatory assets on the balance sheets. These regulatory assets represent timing differences between the recognition of costs in accordance with U.S. GAAP and costs recovered through the rate-making process.

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

	Years Ended March 31,	
	2017	2016
	<i>(in thousands of dollars)</i>	
Balance as of the beginning of the year	\$ 14,311	\$ 15,037
Accretion expense	929	817
Liabilities settled	<u>(228)</u>	<u>(1,543)</u>
Balance as of the end of the year	<u>\$ 15,012</u>	<u>\$ 14,311</u>

Employee Benefits

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

Supplemental Executive Retirement Plans

The Company has corporate assets included in other non-current assets on the balance sheet representing funds designated for Supplemental Executive Retirement Plans. These funds are invested in corporate owned life insurance policies and available-for-sale securities primarily consisting of equity investments and investments in municipal and corporate bonds. The corporate owned life insurance investments are measured at cash surrender value with increases and decreases in the value of these assets recorded in the accompanying statements of income.

New and Recent Accounting Guidance

Accounting Guidance Adopted in Fiscal Year 2017

Presentation of Financial Statements – Balance Sheet Classification of Debt Issuance Costs

In April 2015, the FASB issued ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs." The new guidance requires that debt issuance costs related to term loans, be presented in the balance sheets as a direct deduction from the carrying value of debt. The guidance was adopted and retrospectively applied as described in Note 9, "Capitalization."

Presentation of Financial Statements – Going Concern, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern

In August 2014, the FASB issued amendments on reporting about an entity's ability to continue as a going concern in ASU 2014-15, "Presentation of Financial Statements – Going Concern (Subtopic 205 - 40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern." The amendments provide guidance about management's responsibility to evaluate whether there is substantial doubt surrounding an entity's ability to continue as a going concern. If management concludes that substantial doubt exists, the amendments require additional disclosures relating to management's evaluation and conclusion. Management is not aware of any indicators giving rise to substantial doubt about the Company's ability to continue to operate and to meet its obligations as they fall due.

Accounting Guidance Not Yet Adopted

Pension and Postretirement Benefits

In March 2017, the FASB issued ASU 2017-07, "Compensation Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost," which changes certain presentation and disclosure requirements for employers that sponsor defined benefit pension and other postretirement benefit plans. The ASU requires the service cost component of the net benefit cost to be in the same line item as other compensation in operating income and the other components of net benefit cost to be presented outside of operating income on a retrospective basis. In addition, only the service cost component will be eligible for capitalization when applicable, on a prospective basis. For the Company, the requirements of the new standard will be effective for the fiscal year ended March 31, 2020, with early adoption permitted. The Company is currently evaluating the impact of the new guidance on the presentation, results of operations, cash flows, and financial position.

Goodwill

In January 2017, the FASB issued ASU 2017-04, "Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment," which eliminates Step 2 from the goodwill impairment test. For the Company, the requirements of the new standard will be effective for the fiscal year ended March 31, 2023, with early adoption permitted. The Company currently anticipates adopting the ASU in the year ended March 31, 2018.

Statement of Cash Flows

In November 2016, the FASB issued ASU No. 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)," which requires entities to show the changes in the total of cash, cash equivalents, restricted cash, and restricted cash equivalents in the statement of cash flows. For the Company, the requirements of the new standard will be effective for the fiscal year ended March 31, 2020, and interim periods thereafter, with early adoption permitted.

In August 2016, the FASB issued ASU No. 2016-15, "Classification of Certain Cash Receipts and Cash Payments (Topic 230)," which provides guidance about the classification of certain cash receipts and payments within the statement of cash flows, including debt prepayment or extinguishment costs, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims and policies, and distributions received from equity method investments. For the Company, the requirements of the new standard will be effective for the fiscal year ended March 31, 2020, and interim periods thereafter, with early adoption permitted.

The Company is currently evaluating the impact of the new guidance on the presentation of its statements of cash flows.

Income Taxes

In October 2016, the FASB issued ASU No. 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory," which eliminates the exception for all intra-entity sales of assets other than inventory. As a result, a reporting entity would recognize the tax expense from the sale of the asset in the seller's tax jurisdiction when the transfer occurs, even though the pre-tax effects of that transaction are eliminated in consolidation. For the Company, the requirements of the new standard will be effective for the fiscal year ended March 31, 2020, and interim periods thereafter, with early adoption permitted. The Company is currently evaluating the impact of the new guidance on the results of operations, cash flows, and financial position.

Financial Instruments – Credit Losses

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendment replaces the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For the Company, the requirements of the new standard will be effective for the fiscal year ended March 31, 2022, and interim periods thereafter, with early adoption permitted. The Company is currently evaluating the impact of the new guidance on the results of operations, cash flows, and financial position.

Revenue Recognition

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606), which changes the criteria for recognizing revenue from a contract with a customer. In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers – Deferral of the Effective Date", which effectively defers by one year the effective date of ASU 2014-09. The underlying principle of "Revenue from Contracts with Customers" is that an entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled to, in exchange for those goods or services.

Additionally, there were subsequent amendments to ASU 2014-09. In March 2016, the FASB issued ASU 2016-08, which clarifies the implementation guidance on principal versus agent considerations. In April 2016, the FASB issued ASU No. 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing," which provides guidance in the new revenue standard on identifying performance obligations and accounting for licenses of intellectual property. In May 2016, the FASB issued ASU 2016-12, providing additional clarity on various aspects of Topic 606. Lastly, in December 2016, the FASB issued ASU No. 2016-20, "Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers." The amendments in this Update cover a variety of corrections and improvements to the Codification related to the new revenue recognition standard.

The new revenue recognition guidance and related amendments must be adopted using either a full retrospective approach or a modified retrospective approach. For the Company, the new guidance is effective for the fiscal year ended March 31, 2019, and interim periods within the reporting period, with early adoption permitted.

The Company continues to assess the impacts this guidance may have on its results of operations, cash flows and financial position. In performing this assessment the Company is utilizing an implementation team comprising both internal and external resources. The key areas of focus include but not limited to: reviewing the potential new disclosures regarding the nature, amount, timing and uncertainty of revenue and related cash flows; developing an implementation approach and process for complying with these new disclosures; and evaluating existing contracts and revenue streams for potential changes in the amounts and timing of recognizing revenues under the new guidance. While there continues to be ongoing activities in all these areas, the Company has preliminarily concluded that it expects to apply the new guidance using the modified retrospective method.

Leases

In February 2016, the FASB issued a new lease accounting standard, ASU 2016-02, "Leases (Topic 842)." The key objective of the new standard is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Lessees will need to recognize a right-of-use asset and a lease liability for virtually all of their leases (other than leases that meet the definition of a short-term lease). For income statement purposes, a dual model has been retained, with leases to be designated as operating leases or finance leases. Expenses will be recognized on a straight-line basis for operating leases, and a front-loaded basis for finance leases. For the Company, the new standard is effective for the fiscal year ended March 31, 2021, and interim periods thereafter, with early adoption permitted. The new standard must be adopted using a modified retrospective transition, and provides for certain practical expedients. The Company is currently evaluating the impact of the new guidance on the results of operations, cash flows, and financial position of the Company. The Company's leases are discussed in Note 12, "Commitments and Contingencies" under "Operating Lease Obligations."

Financial Instruments – Classification and Measurement

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities." The new guidance principally affects the accounting for equity investments and financial liabilities where the fair value option has been elected, as well as the disclosure requirements for financial instruments. For the Company, the new guidance is effective for the fiscal year ended March 31, 2020, and interim periods thereafter, with early adoption permitted. The Company is currently evaluating the impact of the new guidance on the results of operations, cash flows, and financial position of the Company.

Measurement of Inventory

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory." The new guidance requires that inventory be measured at the lower of cost or net realizable value (other than inventory measured using "last-in, first out" and the "retail inventory method"). For the Company, the new guidance, which must be applied prospectively, is effective for the fiscal year ended March 31, 2018, and interim periods thereafter, with early adoption permitted. The application of this guidance is not expected to have a material impact on the results of operations, cash flows, or financial position of the Company since the Company's gas in storage is fully recoverable from customers and material and supplies inventory is stated at the lower of cost or market.

Financial Statement Revision

During 2017, management determined that certain transactions were not properly recorded in the Company's previously issued financial statements. The Company has corrected the errors by revising the prior period financial statements presented herein, the impacts of which are described below. The Company concluded that the corrections were not material to any prior periods.

During fiscal year March 31, 2015, the Company recorded an adjustment in accordance with a DPU order to recognize carrying charges on its Post-Retirement Benefits other than Pension (PBOP) liability balances. However, that adjustment was not properly reflected in the LDAC deferral. The Company recorded a cumulative adjustment of \$5.1 million (net of income taxes) to the PBOP regulatory account. Additionally, \$3.0 million and \$2.1 million were recorded as a decrease to net income for the years ended March 31, 2016 and 2015, respectively.

In addition, during the review of the capital tracker regulatory account, the Company noted that a disallowance was improperly captured in the regulatory deferrals. An adjustment of \$1.2 million (net of income taxes) was recorded, of which \$78 thousand was recorded as an increase to opening retained earnings as of March 31, 2015. Additionally, a \$10 thousand and \$1.1 million increase to net income was recorded for the years ended March 31, 2016 and 2015, respectively.

Management also identified an error in the Local Distribution Adjustment Clause (LDAC) recoveries, which improperly excluded certain special ledger customer classes. An adjustment of \$0.5 million was recorded as a decrease to opening

retained earnings as of March 31, 2015. Additionally, a \$19 thousand and \$17 thousand decrease to net income was recorded net for year ended March 31, 2016 and 2015, respectively.

Finally, during a review of the gas cost adjustment regulatory account, management identified a formula error in the deferral calculation. An adjustment of \$0.6 million (net of income taxes) was recorded as a decrease to net income for the year ended March 31, 2016.

Additionally, certain reclassifications have been made to the financial statements to conform prior year's data to the current year's presentation. These reclassifications had no effect on the Company's financial position, results of operations or cash flows. The primary reclassification is a result of retrospective adoption of ASU 2015-03. Refer to Note 9, "Capitalization."

The cumulative adjustments did not result in any changes to the Statement of Cash Flows for March 2016 and 2015.

	As Previously Reported	Presentation Reclassifications	Adjustments	As Revised
	<i>(in thousands of dollars)</i>			
Statement of Income	March 2016			March 2016
Operating revenues	\$ 985,584	\$ -	\$ (118)	\$ 985,466
Total operating expense	848,671	-	1,069	849,740
Operating income	136,913	-	(1,187)	135,726
Total other deductions, net	(23,064)	-	(5,016)	(28,080)
Income before income taxes	113,849	-	(6,203)	107,646
Income tax expense	46,393	-	(2,494)	43,899
Net income	67,456	-	(3,709)	63,747
Statement of Income	March 2015			March 2015
Operating revenues	\$ 1,323,544	\$ -	\$ 1,997	\$ 1,325,541
Operating income	99,315	-	1,997	101,312
Total other deductions, net	(37,711)	-	(3,561)	(41,272)
Income before income taxes	61,604	-	(1,564)	60,040
Income tax expense	25,173	-	(628)	24,545
Net income	36,431	-	(936)	35,495
	As Previously Reported	Presentation Reclassifications	Adjustments	As Revised
Balance Sheet	March 2016			March 2016
Total current assets	\$ 419,890	\$ -	\$ (6,732)	\$ 413,158
Total other non-current assets	568,873	(4,598)	(1,805)	562,470
Total assets	3,734,283	(4,598)	(8,537)	3,721,148
Total current liabilities	513,274	(7,590)	-	505,684
Total other non-current liabilities	1,235,555	7,590	(3,432)	1,239,713
Long-term debt	611,000	(4,598)	-	606,402
Total liabilities and capitalization	3,734,283	(4,598)	(8,537)	3,721,148
Retained Earnings				
March 31, 2016	347,525	-	(5,105)	342,420
March 31, 2015	280,069	-	(1,395)	278,674
March 31, 2014	243,638	-	(460)	243,178
Shareholders' equity				
March 31, 2016	1,374,454	-	(5,105)	1,369,349
March 31, 2015	1,294,238	-	(1,395)	1,292,843
March 31, 2014	1,257,800	-	(460)	1,257,340

3. REGULATORY ASSETS AND LIABILITIES

The Company records regulatory assets and liabilities that result from the ratemaking process. The following table presents the regulatory assets and regulatory liabilities recorded on the balance sheet:

	March 31,	
	2017	2016
<i>(in thousands of dollars)</i>		
Regulatory assets		
Current:		
Derivative instruments	\$ 1,566	\$ 4,337
Gas costs adjustment	97,551	101,748
Revenue decoupling mechanism	980	18,372
Other	10,114	6,262
Total	<u>110,211</u>	<u>130,719</u>
Non-current:		
Asset retirement obligation	9,938	9,087
Capital tracker	14,725	8,628
Environmental response costs	59,536	52,402
Postretirement benefits	39,829	76,885
Regulatory deferred tax asset	14,522	14,727
Other	157	489
Total	<u>138,707</u>	<u>162,218</u>
Regulatory liabilities		
Current:		
Profit sharing	36,638	40,671
Other	583	-
Total	<u>37,221</u>	<u>40,671</u>
Non-current:		
Cost of removal	608,231	575,689
Other	2,950	2,685
Total	<u>611,181</u>	<u>578,374</u>
Net regulatory liabilities	<u>\$ 399,484</u>	<u>\$ 326,108</u>

Asset retirement obligation: Represents accretion expense deferred as part of the Company's asset retirement obligation and is recovered through rates as part of depreciation expense.

Capital tracker: The Company has in place a Gas Savings Enhancement Plan ("GSEP"), which was approved by the DPU on April 30, 2015 and is designed to provide concurrent recovery of the revenue requirement associated with the Company's capital costs for the replacement of eligible leak prone pipe and ancillary equipment pursuant to the 2014 Gas Leaks Act passed in Massachusetts. This new program will run concurrently with Targeted Infrastructure Replacement ("TIR") Program.

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

Derivative instruments: The Company evaluates open derivative instruments for regulatory deferral by determining if they are probable of recovery from, or refund to, customers through future rates. Derivative instruments that qualify for

recovery are recorded at fair value, with changes in fair value recorded as regulatory assets or regulatory liabilities in the period in which the change occurs.

Environmental response costs: The regulatory assets represent deferred costs associated with the Company's share of the estimated costs to investigate and perform certain remediation activities at former manufactured gas plant ("MGP") sites and related facilities. The Company's rate plans provide for the recovery of previously-incurred costs over a seven year recovery period. The Company believes future costs, beyond the expiration of current rate plans, will continue to be recovered through rates.

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

Postretirement benefits: Primarily represents the excess costs of the Company's pension and PBOP plans over amounts received in rates that are to be recovered in future periods, and the non-cash accrual of net actuarial gains and losses. Also included within this amount are certain pension deferral amounts recorded prior to the acquisition of KeySpan by NGUSA, which are being recovered in rates over a ten year period ending August 2017.

Profit sharing: Represents a portion of deferred margins from off-system sale transactions. Under current rate orders, the Company is required to return 90% of margins earned from such optimization transactions to firm customers. The amounts deferred on the balance sheet will be refunded to customers over the next year.

Regulatory deferred tax asset: Represents unrecovered federal and state deferred taxes of the Company primarily as a result of regulatory flow through accounting treatment and tax rate changes. The income tax benefits or charges for certain plant related timing differences, such as equity AFUDC, are immediately flowed through to, or collected from, customers. The amortization of the related regulatory deferred tax asset, for these items, follows the book life of the underlying plant asset. The Company recorded an increase in the regulatory deferred tax asset during the year ended March 31, 2014 as a result of the increase in deferred tax liabilities stemming from a Massachusetts state income tax rate change. The Company will address the recovery period of the regulatory asset created by the Massachusetts rate change as well as an existing balance representing a historic, unrecovered rate change in its next rate case that is anticipated to be addressed towards the end of 2017.

Revenue decoupling mechanism: As approved by the DPU, the Company has a RDM which allows for seasonal (peak/off peak) adjustments to the Company's delivery rates as a result of the reconciliation between allowed revenue per customer and actual revenue per customer. Any difference between the allowed revenue per customer and the actual revenue per customer is recorded as a regulatory asset or regulatory liability.

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

4. RATE MATTERS

General Rate Case

In November 2010, the DPU issued an order in the Company's 2010 rate case approving a revenue increase of \$41.5 million based upon a 9.75% rate of return on equity and a 50% equity ratio. In response, the Company filed a motion for recalculation of certain adjustments. The DPU awarded an increase of \$2.6 million of the additional \$4.9 million requested, effective November 1, 2011. The combined effect of the DPU's orders was a total revenue increase of \$44.1 million. Rates have remained in effect since this time.

Gas System Enhancement Plan

In calendar years 2015, 2016 and 2017, the DPU approved the Company's Gas System Enhancement Plans ("GSEP") for calendar year 2015, 2016 and 2017, respectively, and the associated Gas System Enhancement Adjustment Factors ("GSEAFs"). The approved GSEAFs are designed to provide concurrent recovery of the revenue requirement associated with the Company's capital costs for the replacement of eligible leak prone pipe and ancillary equipment pursuant to Massachusetts' 2014 Gas Leaks Act. This program replaced the Targeted Infrastructure Replacement ("TIR") Program in 2015, however, recovery of the revenue requirement for TIR Program investment will continue until recovery commences through new base distribution rates. The approved GSEAFs are designed to recover from all firm sales and transportation customers a revenue requirement of approximately \$50.6 million for 2017, \$25.1 million for 2016 and \$8.3 million for 2015. Approximately \$5.5 million of the requested revenue requirement for 2017 exceeds the 1.5% revenue cap established in the GSEP legislation, so this amount will be deferred for further recovery under the GSEP or in the next rate case. On April 29, 2016, the Company submitted its first GSEP reconciliation filing for 2015, which reconciled the 2015 revenue requirement on 2015 actual GSEP capital investment with revenue billed through the GSEAFs, and proposed to credit customers \$2.6 million as a result of this reconciliation effective November 1, 2016. The DPU approved the Company's filing and the associated Gas System Enhancement Reconciliation Adjustment Factors ("GSEAFs") on October 31, 2016, but deemed approximately \$17.4 million of project costs ineligible for the GSEP program due to the timing of the projects. These projects were subsequently included in the following TIR program filing submitted on May 1, 2017. The DPU's order further directed the Company to reconcile the revenue requirement associated with approximately \$17.4 million of project costs incurred in 2015 in its May 1, 2017 GSEP reconciliation filing. Additionally, on October 31, 2016, the Company submitted its 2017 GSEP for calendar year 2017 which included a revenue requirement of approximately \$48.2 million. Approximately \$5.4 million of that requested revenue requirement is over the 1.5% cap established in the GSEP legislation.

Service Quality Performance

The Company reported a service quality penalty of approximately \$680,000 for its calendar year 2016 performance on the service appointments met metric of the DPU's service quality guidelines. The Company's request for a waiver of the service quality guidelines which would eliminate this penalty is currently pending before the DPU. The Company cannot currently predict the outcome of the waiver request.

5. PROPERTY, PLANT AND EQUIPMENT

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

	March 31,	
	2017	2016
	<i>(in thousands of dollars)</i>	
Plant and machinery	\$ 3,716,903	\$ 3,407,618
Land and buildings	76,512	63,228
Assets in construction	163,993	117,438
Software and other intangibles	75,723	75,723
Total property, plant and equipment	4,033,131	3,664,007
Accumulated depreciation and amortization	(944,360)	(918,487)
Property, plant and equipment, net	\$ 3,088,771	\$ 2,745,520

6. DERIVATIVE INSTRUMENTS

The Company utilizes derivative instruments to manage commodity price risk associated with its natural gas purchases. The Company's commodity risk management strategy is to reduce fluctuations in firm gas sales prices to its customers.

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

Volumes

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

	March 31,	
	2017	2016
	<i>(In thousands)</i>	
Gas purchase contracts	10,263	3,056
Gas swap contracts	17,910	17,750
Total	28,173	20,806

Amounts Recognized on the Balance Sheet

	Asset Derivatives		Liability Derivatives	
	March 31,		March 31,	
	2017	2016	2017	2016
	<i>(in thousands of dollars)</i>		<i>(in thousands of dollars)</i>	
Current assets:			Current liabilities:	
Rate recoverable contracts:			Rate recoverable contracts:	
Gas purchase contracts	\$ 32	\$ 63	Gas purchase contracts	\$ 1,167
Gas swap contracts	3,393	542	Gas swap contracts	16
	3,425	605		1,183
Other non-current assets			Other non-current liabilities:	
Rate recoverable contracts:			Rate recoverable contracts:	
Gas swap contracts	-	23	Gas swap contracts	839
Gas purchase contracts	-	-	Gas purchase contracts	2,969
	-	23		3,808
Total	\$ 3,425	\$ 628	Total	\$ 4,991
				\$ 4,966

The changes in fair value of the Company's rate recoverable contracts are offset by changes in regulatory assets and liabilities. As a result, the changes in fair value of those contracts had no impact in the accompanying statements of income. All of the Company's derivative instruments are subject to rate recovery as of March 31, 2017 and 2016.

Credit and Collateral

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

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

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

The Company's credit exposure for all commodity derivative instruments and applicable payables and receivables, net of collateral, and instruments that are subject to master netting agreements, was a liability of \$1.0 million and \$9.7 million as of March 31, 2017 and 2016, respectively.

The aggregate fair value of the Company's commodity derivative instruments with credit-risk-related contingent features that were in a liability position at March 31, 2017 and 2016 was \$0.0 million and \$4.7 million, respectively. The Company had no collateral posted for these instruments at March 31, 2017 or 2016. If the Company's credit rating were to be downgraded by one or two levels, it would not be required to post any additional collateral. If the Company's credit rating were to be downgraded by three levels, it would be required to post \$0.1 million and \$5.3 million additional collateral to its counterparties at March 31, 2017 and 2016, respectively.

Offsetting Information for Derivative Instruments Subject to Master Netting Arrangements

March 31, 2017
Gross Amounts Not Offset in the Balance Sheets
(In thousands of dollars)

	Gross amounts of recognized assets <i>A</i>	Gross amounts offset in the Balance Sheets <i>B</i>	Net amounts of assets presented in the Balance Sheets <i>C=A+B</i>	Financial Instruments <i>Da</i>	Cash collateral received <i>Db</i>	Net amount <i>E=C-D</i>
ASSETS:						
Derivative instruments						
Gas purchase contracts	\$ 32	\$ -	\$ 32	\$ -	\$ -	\$ 32
Gas swap contracts	3,393	-	3,393	-	-	3,393
Total	<u>\$ 3,425</u>	<u>\$ -</u>	<u>\$ 3,425</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,425</u>

	Gross amounts of recognized liabilities <i>A</i>	Gross amounts offset in the Balance Sheets <i>B</i>	Net amounts of liabilities presented in the Balance Sheets <i>C=A+B</i>	Financial Instruments <i>Da</i>	Cash collateral paid <i>Db</i>	Net amount <i>E=C-D</i>
LIABILITIES:						
Derivative instruments						
Gas purchase contracts	\$ 4,136	\$ -	\$ 4,136	\$ -	\$ -	\$ 4,136
Gas swap contracts	855	-	855	-	-	855
Total	<u>\$ 4,991</u>	<u>\$ -</u>	<u>\$ 4,991</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,991</u>

March 31, 2016
Gross Amounts Not Offset in the Balance Sheets
(in thousands of dollars)

ASSETS:	Gross amounts of recognized assets <i>A</i>	Gross amounts offset in the Balance Sheets <i>B</i>	Net amounts of assets presented in the Balance Sheets <i>C=A+B</i>	Financial Instruments <i>Da</i>	Cash collateral received <i>Db</i>	Net amount <i>E=C-D</i>
Derivative instruments						
Gas purchase contracts	\$ 63	\$ -	\$ 63	\$ -	\$ -	\$ 63
Gas swap contracts	565	-	565	-	-	565
Total	<u>\$ 628</u>	<u>\$ -</u>	<u>\$ 628</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 628</u>

LIABILITIES:	Gross amounts of recognized liabilities <i>A</i>	Gross amounts offset in the Balance Sheets <i>B</i>	Net amounts of liabilities presented in the Balance Sheets <i>C=A+B</i>	Financial Instruments <i>Da</i>	Cash collateral paid <i>Db</i>	Net amount <i>E=C-D</i>
Derivative instruments						
Gas swap contracts	\$ 4,966	\$ -	\$ 4,966	\$ -	\$ -	\$ 4,966
Total	<u>\$ 4,966</u>	<u>\$ -</u>	<u>\$ 4,966</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,966</u>

7. FAIR VALUE MEASUREMENTS

The following tables present assets and liabilities measured and recorded at fair value on the balance sheet on a recurring basis and their level within the fair value hierarchy as of March 31, 2017 and 2016:

	March 31, 2017			Total
	Level 1	Level 2	Level 3	
	<i>(in thousands of dollars)</i>			
Assets:				
Derivative instruments				
Gas purchase contracts	\$ -	\$ 32	\$ -	\$ 32
Gas swap contracts	-	3,393	-	3,393
Available-for-sale securities	327	370	-	697
Total	<u>327</u>	<u>3,795</u>	<u>-</u>	<u>4,122</u>
Liabilities:				
Derivative instruments				
Gas purchase contracts	-	4	4,132	4,136
Gas swap contracts	-	855	-	855
Total	<u>-</u>	<u>859</u>	<u>4,132</u>	<u>4,991</u>
Net assets (liabilities)	<u>\$ 327</u>	<u>\$ 2,936</u>	<u>\$ (4,132)</u>	<u>\$ (869)</u>

	March 31, 2016			
	Level 1	Level 2	Level 3	Total
	<i>(In thousands of dollars)</i>			
Assets:				
Derivative instruments				
Gas purchase contracts	\$ -	\$ 11	\$ 52	\$ 63
Gas swap contracts	-	565	-	565
Available-for-sale securities	313	367	-	680
Total	<u>313</u>	<u>943</u>	<u>52</u>	<u>1,308</u>
Liabilities:				
Derivative Instruments				
Gas swap contracts	-	4,966	-	4,966
Total	<u>-</u>	<u>4,966</u>	<u>-</u>	<u>4,966</u>
Net assets (liabilities)	<u>\$ 313</u>	<u>\$ (4,023)</u>	<u>\$ 52</u>	<u>\$ (3,658)</u>

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

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

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

Changes in Level 3 Derivative Instruments

	Years Ended March 31,	
	2017	2016
	<i>(in thousands of dollars)</i>	
Balance as of the beginning of the year	\$ 52	\$ (30)
Total gains or losses included in regulatory assets and liabilities	(13,933)	1,659
Settlements	9,749	(1,577)
Balance as of the end of the year	<u>\$ (4,132)</u>	<u>\$ 52</u>

A transfer into Level 3 represents existing assets or liabilities that were previously categorized at a higher level for which the inputs became unobservable during the year. A transfer out of Level 3 represents assets and liabilities that were previously classified as Level 3 for which the inputs became observable based on the criteria discussed previously for classification in Level 2. These transfers, which are recognized at the end of each period, result from changes in the observability of forward curves from the beginning to the end of each reporting period. There were no transfers between Level 1 and Level 2, and no transfers into or out of Level 3, during the years ended March 31, 2017 and 2016.

For valuations that include both observable and unobservable inputs, if the unobservable input is determined to be significant to the overall inputs, the entire valuation is categorized in Level 3. This includes derivative instruments valued using indicative price quotations whose contract tenure extends into unobservable periods. In instances where observable data is unavailable, consideration is given to the assumptions that market participants would use in valuing the asset or liability. This includes assumptions about market risks such as liquidity, volatility, and contract duration. Such instruments are categorized in Level 3 as the model inputs generally are not observable. The forward curves used for financial reporting are developed and verified by the middle office. The Company considers non-performance risk and liquidity risk in the valuation of derivative instruments categorized in Level 2 and Level 3.

Quantitative Information About Level 3 Fair Value Measurements

The following tables provide information about the Company's Level 3 valuations:

Commodity	Level 3 Position	Fair Value as of March 31, 2017			Valuation Technique(s)	Significant Unobservable Input	Range
		Assets	(Liabilities)	Total			
<i>(thousands of dollars)</i>							
Gas	Purchase contracts	-	(4,132)	(4,132)	Forward Curve	Unobservable Basis Points	\$9.8418 - \$10.8906/dth
	Total	<u>\$ -</u>	<u>\$ (4,132)</u>	<u>\$ (4,132)</u>			

Commodity	Level 3 Position	Fair Value as of March 31, 2016			Valuation Technique(s)	Significant Unobservable Input	Range
		Assets	(Liabilities)	Total			
<i>(thousands of dollars)</i>							
Gas	Purchase contracts	52	-	52	Forward Curve	Unobservable Basis Points	\$8.99 - \$9.05/dth
	Total	<u>\$ 52</u>	<u>\$ -</u>	<u>\$ 52</u>			

The significant unobservable inputs listed above would have a direct impact on the fair values of the Level 3 instruments if they were adjusted. The significant unobservable inputs used in the fair value measurement of the Company's gas purchase derivative instruments are forward curve and unobservable basis points. A relative change in commodity price at various locations underlying the open positions can result in significantly different fair value estimates.

Other Fair Value Measurements

The Company's balance sheets reflect long-term debt at amortized cost. The fair value of the Company's long-term debt was based on quoted market prices when available, or estimated using quoted market prices for similar debt. The fair value of this debt at March 31, 2017 and 2016 was \$656.4 million and \$693.2 million, respectively.

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

8. EMPLOYEE BENEFITS

Pension Benefits

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

Pension Plans

The Pension Plan is a defined benefit plan which provides union employees, as well as non-union employees hired before January 1, 2011, with a retirement benefit. Supplemental non-qualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives. The Pension Plans' costs are allocated to the Company based on plan participant data as determined by the Company's actuaries.

The Company contributed \$13.8 million, \$10.8 million and \$13.8 million for the years ended March 31, 2017, 2016 and 2015 respectively, to the trusts of its qualified Pension Plans.

The Pension Plans' assets are commingled and cannot be allocated to an individual company. The Pension Plans' costs and liabilities are first directly charged to the Company based on the Company's employees that participate in the Pension Plans. Costs and liabilities associated with affiliated service companies' employees are then allocated as part of the labor burden for work performed on the Company's behalf. The Company's net pension expense directly charged and allocated from affiliated service companies, net of capital, for the years ended March 31, 2017, 2016 and 2015 was \$17.7 million, \$16.5 million and \$18.3 million respectively.

KeySpan's unfunded pension obligation at March 31, 2017 was \$0.7 billion, and \$1 billion for 2016 and 2015. The Company's portion of KeySpan's unfunded pension obligations which are included in postretirement benefits on the balance sheet at March 31, 2017, 2016 and 2015 was an overfunding of \$21.4 million, \$4.4 million and \$1.4 million, respectively.

Defined Contribution Plan

NGUSA has a defined contribution pension plan that covers substantially all employees. For the years ended March 31, 2017, 2016 and 2015, the Company recognized an expense in the accompanying statements of income of \$1.5 million, \$1.4 million and \$1.5 million, respectively, for matching contributions.

Other Postretirement Benefits

The PBOP plans have not been merged with other KeySpan plans and, therefore, continue to remain separate plans of the Company. The PBOP plans provide health care and life insurance coverage to eligible retired employees. Eligibility is based on age and length of service requirements and, in most cases, retirees must contribute to the cost of their coverage. The PBOP assets are commingled with the KeySpan Union VEBA Master Trust, KeySpan Non-Union Medical VEBA Master Trust, and KeySpan Non-Union Life VEBA Master Trust. The Company's portion were approximately 7%, 8% and 8% for each of the years ended March 31, 2017, 2016 and 2015, respectively. PBOP expenses are included in operations and maintenance expense in the accompanying statements of income. The Company's unfunded PBOP obligations were \$67.8 million, \$90.5 million and \$99.3 million at March 31, 2017, 2016 and 2015, respectively. These are included in postretirement benefits on the balance sheet.

Components of Net Periodic PBOP Costs

	Years Ended March 31,		
	2017	2016	2015
	<i>(in thousands of dollars)</i>		
Service cost	\$ 3,072	\$ 3,244	\$ 2,886
Interest cost	6,634	6,745	7,400
Expected return on plan assets	(5,003)	(4,917)	(4,819)
Amortization of prior service cost, net	76	78	76
Amortization of net actuarial loss	(58)	218	(300)
Total cost	\$ 4,721	\$ 5,368	\$ 5,243

Amounts Recognized in Regulatory Assets

The following tables summarize other pre-tax changes in plan assets and benefit obligations recognized primarily in regulatory assets for the years ended March 31, 2017, 2016, and 2015:

	Years Ended March 31,		
	2017	2016	2015
	<i>(in thousands of dollars)</i>		
Net actuarial gain	\$ (16,343)	\$ (3,732)	\$ (3,002)
Amortization of net actuarial (gain) loss	58	(218)	300
Amortization of prior service cost, net	(76)	(78)	(76)
Total	\$ (16,361)	\$ (4,028)	\$ (2,778)

A portion of the estimated PBOP net actuarial loss and prior service cost of \$(0.2) million and \$0.1 million, respectively, will be amortized from regulatory assets during the year ended March 31, 2018.

Amounts Recognized in Regulatory Assets – not yet recognized as components of net actuarial loss

The following tables summarize the Company's amounts in regulatory assets on the balance sheet that have not yet been recognized as components of net actuarial loss at March 31, 2017, 2016, and 2015

	Years Ended March 31,		
	2017	2016	2015
	<i>(in thousands of dollars)</i>		
Net actuarial loss	\$ (4,807)	\$ 11,478	\$ 15,428
Prior service cost	126	202	280
Total	\$ (4,681)	\$ 11,680	\$ 15,708

Reconciliation of Funded Status to Amount Recognized

The following table represents the PBOP obligation, assets, and funded status:

	<u>Years Ended March 31,</u>	
	<u>2017</u>	<u>2016</u>
	<i>(in thousands of dollars)</i>	
Change in benefit obligation:		
Benefit obligation as of the beginning of the year	\$ (164,470)	\$ (173,011)
Service cost	(3,072)	(3,244)
Interest cost on projected benefit obligation	(6,634)	(6,745)
Net actuarial loss	12,804	10,334
Benefits paid	9,985	8,966
Employer group waiver plan subsidy received	(647)	(770)
Benefit obligation as of the end of the year	<u>(152,034)</u>	<u>(164,470)</u>
Change in plan assets:		
Fair value of plan assets as of the beginning of the year	73,996	73,680
Actual return on plan assets	8,542	(1,685)
Company contributions	11,684	10,967
Benefits paid	(9,985)	(8,966)
Fair value of plan assets as of the end of the year	<u>84,237</u>	<u>73,996</u>
Funded status	<u>\$ (67,797)</u>	<u>\$ (90,474)</u>

The Company is the sponsor of the PBOP plans. A portion of the participants of these plans work for certain other affiliates. As such, a portion of the PBOP expenses and the unfunded obligation has been allocated to these affiliates. The Company has recorded an intercompany payable of \$2.6 million and an intercompany receivable of \$3.2 million as of March 31, 2017 and 2016, respectively, for the amount of the unfunded obligation between these affiliates.

Expected Benefit Payments

Based on current assumptions, the Company expects to make the following PBOP payments subsequent to March 31, 2017:

<i>(in thousands of dollars)</i>	
<u>Years Ending March 31,</u>	
2018	\$ 9,302
2019	9,460
2020	9,706
2021	9,875
2022	10,273
Thereafter	51,930
Total	<u>\$ 100,546</u>

Assumptions Used for Employee Benefits Accounting

	Years Ended March 31,	
	2017	2016
Benefit Obligations:		
Discount rate	4.30%	4.25%
Expected return on plan assets	6.50% - 6.75%	6.25% - 6.75%
Net Periodic Benefit Costs:		
Discount rate	4.25%	4.10%
Expected return on plan assets	6.25% - 6.75%	6.25% - 6.75%

The Company selects its discount rate assumption based upon rates of return on highly rated corporate bond yields in the marketplace as of each measurement date. Specifically, the Company uses the Hewitt AA Above Median Curve along with the expected future cash flows from the Company retirement plans to determine the weighted average discount rate assumption.

The expected rate of return for various passive asset classes is based both on analysis of historical rates of return and forward looking analysis of risk premiums and yields. Current market conditions, such as inflation and interest rates, are evaluated in connection with the setting of the long-term assumptions. A small premium is added for active management of both equity and fixed income securities. The rates of return for each asset class are then weighted in accordance with the actual asset allocation, resulting in a long-term return on asset rate for each plan.

Assumed Health Cost Trend Rate

	March 31,	
	2017	2016
Health care cost trend rate assumed for next year		
Pre 65	7.00%	7.50%
Post 65	6.00%	6.25%
Prescription	10.25%	11.00%
Rate to which the cost trend is assumed to decline (ultimate)	4.50%	4.50%
Year that rate reaches ultimate trend		
Pre 65	2025	2025
Post 65	2024	2024
Prescription	2025	2025

Sensitivity to Changes in Assumed Health Care Cost Trend Rates

<i>(in thousands of dollars)</i>	March 31, 2017
1% Point increase	
Total of service cost plus interest cost	\$ 649
Postretirement benefit obligation	6,677
1% Point decrease	
Total of service cost plus interest cost	(548)
Postretirement benefit obligation	(5,834)

The Company expects to make \$5.6 million in contributions to the PBOP plans during the year ending March 31, 2018

Plan Assets

NGUSA manages the benefit plan investments to minimize the long-term cost of operating the plans, with a reasonable level of risk. Risk tolerance is determined as a result of a periodic asset/liability study which analyzes the plans' liabilities and funded status and results in the determination of the allocation of assets across equity and fixed income securities. Equity investments are broadly diversified across U.S. and non-U.S. stocks, as well as across growth, value, and small and large capitalization stocks. Likewise, the fixed income portfolio is broadly diversified across market segments. Small investments are also approved for private equity, real estate, and infrastructure with the objective of enhancing long-term returns while improving portfolio diversification. For the PBOP Plans, since the earnings on a portion of the assets are taxable, those investments are managed to maximize after tax returns consistent with the broad asset class parameters established by the asset allocation study. Investment risk and return are reviewed by NGUSA's investment committee on a quarterly basis.

The Pension Plan is a trusted non-contributory defined benefit plan covering all eligible represented employees of the Company and eligible non-represented employees of the participating National Grid companies. The PBOP Plans are both a contributory and non-contributory, trustee, employee life insurance and medical benefit plan sponsored by KeySpan Corporation, a subsidiary of National Grid USA Company, Inc. Life insurance and medical benefits are provided for eligible retirees, dependents, and surviving spouses of National Grid USA Company, Inc. and its subsidiaries.

The target asset allocations for the benefit plans as of March 31, 2017 and 2016 are as follows:

	Pension Plans		PBOP Plans	
	March 31,		March 31,	
	2017	2016	2017	2016
U.S. equities	20%	20%	40%	40%
Global equities (including U.S.)	7%	7%	6%	6%
Global tactical asset allocation	10%	10%	9%	9%
Non-U.S. equities	10%	10%	21%	21%
Fixed income	40%	40%	24%	24%
Private equity	5%	5%	0%	0%
Real estate	5%	5%	0%	0%
Infrastructure	3%	3%	0%	0%
	100%	100%	100%	100%

Fair Value Measurements

The following tables provide the fair value measurements amounts for the PBOP assets:

	March 31, 2017				Total
	Level 1	Level 2	Level 3	Not Categorized	
	<i>(in thousands of dollars)</i>				
PBOP Assets:					
Cash and cash equivalents	\$ 1,544	\$ 71	\$ -	\$ 1	\$ 1,616
Accounts receivable	89	-	-	-	89
Accounts payable	(9)	-	-	-	(9)
Equity	15,291	-	-	35,147	50,438
Global tactical asset allocation	2,348	-	-	5,405	7,753
Fixed income securities	291	14,368	-	9,300	23,959
Futures contracts	2	-	-	-	2
Preferred Securities	-	1	-	-	1
Private equity	-	-	-	371	371
Real estate	-	-	-	5	5
Total	\$ 19,556	\$ 14,440	\$ -	\$ 50,229	\$ 84,225

	March 31, 2016				Total
	Level 1	Level 2	Level 3	Not Categorized	
	<i>(in thousands of dollars)</i>				
PBOP Assets:					
Cash and cash equivalents	\$ 583	\$ 1,072	\$ -	\$ 2	\$ 1,657
Accounts receivable	749	-	-	-	749
Accounts payable	(691)	-	-	-	(691)
Equity	9,453	2,895	-	29,347	41,695
Global tactical asset allocation	2,163	-	-	4,260	6,423
Fixed income securities	150	23,453	-	2	23,605
Futures contracts	-	39	-	-	39
Private equity	-	-	-	514	514
Real estate	-	-	-	5	5
Total	\$ 12,407	\$ 27,459	\$ -	\$ 34,130	\$ 73,996

The methods used to fair value PBOP assets are described below:

Cash and cash equivalents: Cash and cash equivalents that can be priced daily are classified as Level 1. Active reserve funds, reserve deposits, commercial paper, repurchase agreements, and commingled cash equivalents are classified as Level 2. Such instruments are generally valued using a curve methodology that includes observable inputs such as money market rates for specific instruments, programs, currencies and maturity points obtained from a variety of market makers, reflective of current trading levels. The methodologies consider an instrument's days to final maturity to generate a yield based on the relevant curve for the instrument.

Accounts receivable and accounts payable: Accounts receivable and accounts payable are classified as Level 1. Such amounts are short-term and settle within a few days of the measurement date.

Equity securities: Common stock investment trusts are valued using the official close of the primary market on which the individual securities are traded. Equity securities are primarily comprised of securities issued by public companies in

domestic and foreign markets plus investments in commingled funds, which are valued on a daily basis. The Company can exchange shares of the publicly traded securities and the fair values are primarily sourced from the closing prices on stock exchanges where there is active trading, in which case they are classified as Level 1 investments. If there is less active trading, then the publicly traded securities would typically be priced using observable data, such as bid and ask prices, and these measurements are classified as Level 2 investments. Commingled funds with publicly quoted prices and active trading are classified as Level 1 investments. For investments in commingled funds that are not publicly traded and have ongoing subscription and redemption activity, the fair value of the investment is the NAV per fund share, derived from the underlying securities' quoted prices in active markets, and they are excluded from the fair value hierarchy. Investments in commingled funds with redemption restrictions and that use NAV are excluded from the fair value hierarchy.

Global tactical asset allocation: Assets held in global tactical asset allocation funds are managed by investment managers who use both top-down and bottom-up valuation methodologies to value asset classes, countries, industrial sectors, and individual securities in order to allocate and invest assets opportunistically. If the inputs used to measure a financial instrument fall within different levels of the fair value hierarchy within the commingled fund, the categorization is based on the lowest level input that is significant to the measurement of that financial instrument. Those which are open ended mutual funds with observable pricing are classified as Level 1. Investments with redemption restrictions and that use NAV are excluded from the fair value hierarchy.

Fixed income securities: Fixed income securities (which include corporate debt securities, municipal fixed income securities, U.S. Government and Government agency securities including government mortgage backed securities, index linked government bonds, and state and local bonds) convertible securities, and investments in securities lending collateral (which include repurchase agreements, asset backed securities, floating rate notes and time deposits) are valued with an institutional bid valuation. A bid valuation is an estimated price at which a dealer would pay for a security (typically in an institutional round lot). Oftentimes, these evaluations are based on proprietary models which pricing vendors establish for these purposes. In some cases there may be manual sources when primary vendors do not supply prices. Fixed income investments are primarily comprised of fixed income securities and fixed income commingled funds. The prices for direct investments in fixed income securities are generated on a daily basis. Prices generated from less active trading with wider bid ask prices are classified as Level 2 investments. Commingled funds with publicly quoted prices and active trading are classified as Level 1 investments. For commingled funds that are not publicly traded and have ongoing subscription and redemption activity, the fair value of the investment is the NAV per fund share, derived from the underlying securities' quoted prices in active markets, and that use NAV as the practical expedient are excluded from the fair value hierarchy.

Private equity: Commingled equity funds, commingled special equity funds, limited partnerships, real estate, venture capital, and other investments are valued using evaluations (NAV per fund share) based on proprietary models, or based on the NAV. Investments in private equity and real estate funds are primarily invested in privately held real estate investment properties, trusts, and partnerships as well as equity and debt issued by public or private companies. The Company's interest in the fund or partnership is estimated based on the NAV. The Company's interest in these funds cannot be readily redeemed due to the inherent lack of liquidity and the primarily long-term nature of the underlying assets. Distribution is made through the liquidation of the underlying assets. The Company views these investments as part of a long-term investment strategy. These investments are valued by each investment manager based on the underlying assets. The funds utilize valuation techniques consistent with the market, income, and cost approaches to measure the fair value of certain real estate investments. The majority of the underlying assets are valued using significant unobservable inputs and often require significant management judgment or estimation based on the best available information. Market data includes observations of the trading multiples of public companies considered comparable to the private companies being valued. Investments in limited partnerships with redemption restrictions and that use NAV are excluded from the fair value hierarchy.

While management believes its valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the NAV as a practical expedient could result in a different fair value measurement at the reporting date.

Other Benefits

At March 31, 2017, 2016 and 2015, the Company had accrued workers compensation, auto, and general insurance claims which have been incurred but not yet reported ("IBNR") of \$11 million, \$13.5 million and \$12.6 million, respectively. IBNR reserves have been established for claims and/or events that have transpired, but have not yet been reported to the Company for payment

9. CAPITALIZATION

As a result of retrospective adoption of ASU 2015-03, relating to the balance sheet presentation of debt issuance costs, the Company adjusted its long-term debt and other non-current assets by \$4.6 million as of March 31, 2016. Debt issuance costs were \$4.3 million at March 31, 2017

The aggregate maturities of long-term debt for the years subsequent to March 31, 2017 are as follows:

<i>(in thousands of dollars)</i>	
<u>Years Ending March 31,</u>	
2018	\$ 8,000
2019	20,000
2020	7,000
2021	5,000
2022	15,000
Thereafter	<u>556,000</u>
Total	<u>\$ 611,000</u>

The Company's debt agreements and banking facilities contain covenants, including those relating to the periodic and timely provision of financial information by the issuing entity and financial covenants such as restrictions on the level of indebtedness. Failure to comply with these covenants, or to obtain waivers of those requirements, could in some cases trigger a right, at the lender's discretion, to require repayment of some of the Company's debt and may restrict the Company's ability to draw upon its facilities or access the capital markets. During the years ended March 31, 2017 and 2016, the Company was in compliance with all such covenants.

10. INCOME TAXES

Components of Income Tax Expense

	Years Ended March 31,		
	2017	2016	2015
	<i>(in thousands of dollars)</i>		
Current tax expense (benefit):			
Federal	\$ 4,781	\$ (382)	\$ 11,396
State	2,402	2,598	8,906
Total current tax expense (benefit)	<u>7,183</u>	<u>2,216</u>	<u>20,302</u>
Deferred tax expense (benefit):			
Federal	30,478	35,648	8,295
State	6,337	6,035	(4,046)
Total deferred tax expense (benefit)	<u>36,815</u>	<u>41,683</u>	<u>4,249</u>
Amortized investment tax credits ⁽¹⁾	-	-	(7)
Total deferred tax expense	<u>36,815</u>	<u>41,683</u>	<u>4,242</u>
Total income tax expense (benefit)	<u>\$ 43,998</u>	<u>\$ 43,899</u>	<u>\$ 24,544</u>

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

Statutory Rate Reconciliation

The Company's effective tax rates for the years ended March 31, 2017, 2016 and 2015 are 40.5%, 40.8% and 40.9% respectively. The following table presents a reconciliation of income tax expense at the federal statutory tax rate of 35% to the actual tax expense:

	Years Ended March 31,		
	2017	2016	2015
	<i>(in thousands of dollars)</i>		
Computed tax	\$ 38,010	\$ 37,676	\$ 21,014
Change in computed taxes resulting from:			
State income tax, net of federal benefit	5,681	5,612	3,141
Investment tax credits	-	-	(7)
Other items, net	307	611	396
Total	<u>5,988</u>	<u>6,223</u>	<u>3,530</u>
Total income tax expense	<u>\$ 43,998</u>	<u>\$ 43,899</u>	<u>\$ 24,544</u>

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

In December 2015, The Protecting Americans from Tax Hikes Act of 2015 was signed into law, extending bonus depreciation for qualifying property acquired and placed in service before January 1, 2020 (bonus depreciation rates will be 50% in 2015

to 2017, 40% in 2018, and 30% in 2019), with an additional year for certain longer lived assets. The Company will continue to claim bonus depreciation for qualifying property acquired and placed in service in accordance with this change in tax law.

Deferred Tax Components

	March 31,	
	2017	2016
	<i>(in thousands of dollars)</i>	
Deferred tax assets:		
Allowance for doubtful accounts	\$ 20,249	\$ 19,125
Environmental remediation costs	17,360	15,436
Future federal benefit on state taxes	27,988	24,743
Postretirement benefits and other employee benefits	44,934	58,578
Regulatory liabilities - other	28,397	26,855
Net operating losses	47,714	24,151
Other items	10,510	17,399
Total deferred tax assets ⁽¹⁾	197,152	186,287
Deferred tax liabilities:		
Property related differences	610,124	537,787
Regulatory assets - deferred gas costs	52,537	63,580
Regulatory assets - environmental response costs	24,992	21,924
Regulatory assets - postretirement benefits	15,193	27,735
Other items	22,799	20,712
Total deferred tax liabilities	725,645	671,738
Deferred income tax liabilities, net	\$ 528,493	\$ 485,451

(1) The Company established a valuation allowance for deferred tax assets related to expiring charitable contribution carryforwards in the amounts of \$0.5 million and \$0.4 million as of March 31, 2017 and March 31, 2016 respectively.

Net Operating Losses

The following table presents the amounts and expiration dates of net operating losses as of March 31, 2017:

Expiration of net operating losses:	Federal	Massachusetts
	<i>(in thousands of dollars)</i>	
3/31/2029	\$ 24,076	-
3/31/2030	15,775	-
3/31/2031	-	-
3/31/2032	15,578	-
3/31/2033	8,980	-
3/31/2034	14,412	-
3/31/2035	-	-
3/31/2036	95,757	21,982
3/31/2037	68,048	1,753

Unrecognized Tax Benefits

As of March 31, 2017, 2016 and 2015, the Company's unrecognized tax benefits totaled \$72.3 million, \$62.8 million and \$58.3 million, respectively, none of which would affect the effective tax rate, if recognized. The unrecognized tax benefits are included in other non-current liabilities on the balance sheet.

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

	Years Ended March 31,		
	2017	2016	2015
	<i>(in thousands of dollars)</i>		
Balance as of the beginning of the year	\$ 62,759	\$ 58,334	\$ 51,554
Gross increases - tax positions in prior periods	1,255	470	522
Gross decreases - tax positions in prior periods	(276)	(2,345)	(2,555)
Gross increases - current period tax positions	8,611	6,300	8,813
Balance as of the end of the year	<u>\$ 72,349</u>	<u>\$ 62,759</u>	<u>\$ 58,334</u>

As of March 31, 2017, 2016 and 2015, the Company has accrued for interest related to unrecognized tax benefits of \$2.7 million, \$2.1 million and \$1.5 million, respectively. During years ended March 31, 2017, 2016 and 2015, the Company recorded interest expense of \$0.6 million, \$0.6 million and \$0.3 million, respectively. The Company recognizes interest related to unrecognized tax benefits in other interest, including affiliate interest and related penalties, if applicable, in other deductions, net, in the accompanying statements of income. No tax penalties were recognized during the years ended March 31, 2017, 2016 or 2015.

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

The Company is included in NGNA and subsidiaries' administrative appeal with the Internal Revenue Service ("IRS") related to the issues disputed in the examination cycles for the years ended August 24, 2007, March 31, 2008 and March 31, 2009. The Company is expecting to reach a settlement with the IRS in the next fiscal year. The Company does not believe that the outcome of the settlement will have a material impact to its results of operations, financial position, or cash flows. The IRS continues its examination of the next cycle which includes income tax returns for the years ended March 31, 2010 through March 31, 2012. The examination is expected to conclude in the next fiscal year. The income tax returns for the years ended March 31, 2013 through March 31, 2017 remain subject to examination by the IRS.

The Massachusetts unitary state income tax returns for the years ended March 31, 2010 through March 31, 2017 remain subject to examination by the Massachusetts Department of Revenue.

The following table indicates the earliest tax year subject to examination for each major jurisdiction:

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

11. ENVIRONMENTAL MATTERS

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

Within the Commonwealth of Massachusetts, the Company is aware of numerous former MGP sites and related facilities within the existing or former service territories of the Company. Investigation and remediation expenditures incurred for the years ended March 31, 2017, 2016 and 2015 were \$6.3 million, \$4.8 million and \$3.7 million, respectively.

In fiscal year 2016 and prior years the Company reflected environmental liabilities on a discounted basis using a 6.5% discount factor. In 2017 the US Environmental Protection Agency ("EPA") required certain NGUSA affiliates, with sites similar to those of the Company, to revise their site remediation plans which increased the cost, complexity and potential time horizon to meet the EPA standards. The revised remediation plans and requirements no longer make it feasible for the Company to realistically determine if the payments for these liabilities are fixed and determinable and subject to discounting at March 31, 2017. In 2017 the Company revised its estimate for environmental liabilities and eliminated the discount factor which resulted in a \$12.4 million increase in the liability and corresponding regulatory asset. This change in estimate had no impact on the Company's results of operations or cash flows

The Company estimated the remaining costs of environmental remediation activities were \$40.4 million and \$35.9 million at March 31, 2017 and 2016, respectively. These costs are expected to be incurred over approximately 54 years. However, remediation costs for each site may be materially higher than estimated, depending on changing technologies and regulatory standards, selected end use for each site, and actual environmental conditions encountered. The Company has recovered amounts from certain insurers and potentially responsible parties, and, where appropriate, the Company may seek additional recovery from other insurers and from other potentially responsible parties, but it is uncertain whether, and to what extent, such efforts will be successful.

By rate orders, the DPU has provided for the recovery of site investigation and remediation costs. Accordingly, as of March 31, 2017 and 2016, the Company has recorded environmental regulatory assets of \$59.5 million and \$52.4 million, respectively.

The Company believes that its ongoing operations, and its approach to addressing conditions at historic sites, are in substantial compliance with all applicable environmental laws. Where the Company has regulatory recovery, it believes that the obligations imposed on it because of the environmental laws will not have a material impact on its results of operations or financial position.

12. COMMITMENTS AND CONTINGENCIES

Operating Lease Commitments

The Company has various direct operating leases relating to office space. Additionally, a portion of the Company's affiliates' lease expense is allocated to the Company according to usage. Total rental expense for operating leases included in operations and maintenance expense in the accompanying statements of income was \$21 million, \$17.2 million and \$14.9 million for the years ended March 31, 2017, 2016 and 2015, respectively.

The future minimum lease payments for the years subsequent to March 31, 2017 are as follows:

<i>(in thousands of dollars)</i>	
<u>Years Ending March 31.</u>	
2018	\$ 3,228
2019	3,280
2020	3,397
2021	3,436
2022	2,852
Thereafter	14,612
Total	<u>\$ 30,805</u>

Purchase Commitments

The Company has entered into various contracts for gas delivery, storage, and supply services. Certain of these contracts require payment of annual demand charges, which are recoverable from customers. The Company is liable for these payments regardless of the level of service required from third-parties. In addition, the Company has various capital commitments related to the construction of property, plant and equipment.

The Company's commitments under these long-term contracts for the years subsequent to March 31, 2017 are summarized in the table below:

<i>(in thousands of dollars)</i>	Gas	Capital
<u>Years Ending March 31.</u>	<u>Purchases</u>	<u>Expenditures</u>
2018	\$ 225,593	\$ 58,451
2019	192,899	-
2020	145,063	-
2021	123,347	-
2022	104,894	-
Thereafter	766,903	-
Total	<u>\$ 1,558,699</u>	<u>\$ 58,451</u>

Legal Matters

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

In fiscal year 2017, the Company reported to the MA Department of Public Utilities and the MA attorney general's office that it erroneously charged reconnection fees to certain customers. These amounts have been refunded or are in the process of being refunded to customers. Additionally, the MA attorney general's office indicated a potential penalty related to this matter, which is expected to be resolved in fiscal year 2018. As of March 31, 2017, the Company has recorded a liability for the balance of fees to be refunded to customers as well as a reserve for the penalty based on the best estimate of the settlement amount.

13. RELATED PARTY TRANSACTIONS

Accounts Receivable from and Accounts Payable to Affiliates

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

The Company records short-term receivables from, and payables to, certain of its affiliates in the ordinary course of business. The amounts receivable from, and payable to, its affiliates do not bear interest and are settled through the intercompany money pool. A summary of net outstanding accounts receivable from affiliates and accounts payable to affiliates is as follows:

	from Affiliates		to Affiliates	
	March 31,		March 31,	
	2017	2016	2017	2016
	<i>(in thousands of dollars)</i>			
Colonial Gas Company	\$ -	\$ -	\$ 15,101	\$ 4,511
KeySpan Corporation	-	-	36,598	17,887
National Grid Generation LLC	111	111	-	-
NGUSA Service Company	1,850	1,851	16,734	18,951
Other	20	22	2,280	1,775
Total	\$ 1,981	\$ 1,984	\$ 70,713	\$ 43,124

At March 31, 2017 and 2016, the non-current portion of accounts receivable from affiliates represents the PBOP liability of \$2.6 million and \$3.2 million, respectively, allocated to various affiliated entities as disclosed in Note 8, "Employee Benefits."

Intercompany Money Pool

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

The Regulated Money Pool is funded by operating funds from participants. Collectively, NGUSA and its subsidiary KeySpan have the ability to borrow up to \$3 billion from National Grid plc for working capital needs including funding of the Regulated Money Pool, if necessary. The Company had short-term intercompany money pool borrowings of \$547.9 million and \$321.7 million at March 31, 2017 and 2016, respectively. The average interest rates for the intercompany money pool were 1.07% and 0.70% and 0.3% for the years ended March 31, 2017, 2016 and 2015, respectively

Service Company Charges

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

Net charges to and from the service companies of NGUSA, including but not limited to non-power goods and services, for the years ended March 31, 2017, 2016 and 2015 were \$219.4 million, \$200.9 million and \$195.3 million, respectively.

Holding Company Charges

NGUSA received charges from National Grid Commercial Holdings Limited (an affiliated company in the United Kingdom) for certain corporate and administrative services provided by the corporate functions of National Grid plc to its U.S. subsidiaries. These charges, which are recorded on the books of NGUSA, have not been reflected in these financial statements. The estimated amount related to the Company would be \$3.6 million, \$2.6 million and \$3.8 million for the years ended March 31, 2017, 2016 and 2015, respectively.