

Boston Gas Company

d/b/a National Grid

Financial Statements

For the years ended March 31, 2016 and 2015

BOSTON GAS COMPANY

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Independent Auditor's Report

To the Board of Directors
of Boston Gas Company

We have audited the accompanying financial statements of Boston Gas Company (the Company), which comprise the balance sheets and statements of capitalization as of March 31, 2016 and 2015, and the related statements of income, comprehensive income, cash flows, and changes in shareholder's equity for the years then ended.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Boston Gas Company at March 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Emphasis of Matter

As discussed in Note 2 to the financial statements, the Company has restated its financial statements as of and for the year ended March 31, 2015 to correct errors. Our opinion is not modified with respect to this matter.

PricewaterhouseCoopers LLP

September 2, 2016

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

	Years Ended March 31,	
	2016	2015 (Restated)
Operating revenues	\$ 985,584	\$ 1,323,544
Operating expenses:		
Purchased gas	309,096	579,711
Operations and maintenance	346,721	455,619
Depreciation and amortization	139,400	131,408
Other taxes	53,454	57,491
Total operating expenses	848,671	1,224,229
Operating income	136,913	99,315
Other income and (deductions):		
Interest on long-term debt	(32,657)	(32,999)
Other interest, including affiliate interest	11,251	(1,274)
Other deductions, net	(1,658)	(3,438)
Total other deductions, net	(23,064)	(37,711)
Income before income taxes	113,849	61,604
Income tax expense	46,393	25,173
Net income	\$ 67,456	\$ 36,431

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,	
	2016	2015 (Restated)
Net income	\$ 67,456	\$ 36,431
Other comprehensive income (loss):		
Unrealized (losses) gains on securities	(14)	7
Total other comprehensive (loss) income	(14)	7
Comprehensive income	\$ 67,442	\$ 36,438
Related tax (expense) benefit:		
Unrealized losses (gains) on securities	\$ 9	\$ (5)
Total tax benefit (expense)	\$ 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,	
	2016	2015 <i>(Restated)</i>
Operating activities:		
Net income	\$ 67,456	\$ 36,431
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	139,400	131,408
Provision for deferred income taxes	44,177	4,871
Bad debt expense	20,933	33,109
Net postretirement benefits expense (contributions)	2,318	(8,648)
Net environmental remediation payments	(4,824)	(3,676)
Changes in operating assets and liabilities:		
Accounts receivable and other receivable, net, and unbilled revenues	116,019	(34,183)
Inventory	(6,904)	(10,313)
Regulatory assets and liabilities, net	(53,491)	62,781
Derivative instruments	(9,097)	7,063
Prepaid and accrued taxes	(18,764)	7,273
Accounts payable and other liabilities	(22,673)	(57,102)
Other, net	841	160
Net cash provided by operating activities	275,391	169,174
Investing activities:		
Capital expenditures	(321,163)	(299,758)
Cost of removal	(22,325)	(20,126)
Net cash used in investing activities	(343,488)	(319,884)
Financing activities:		
Payments on long-term debt	(10,000)	(2,000)
Affiliated money pool borrowing and receivables/payables, net	67,721	155,210
Parent loss tax allocation	12,774	-
Net cash provided by financing activities	70,495	153,210
Net increase in cash and cash equivalents	2,398	2,500
Cash and cash equivalents, beginning of year	2,500	-
Cash and cash equivalents, end of year	\$ 4,898	\$ 2,500
Supplemental disclosures:		
Interest paid	\$ (32,721)	\$ (36,539)
Income taxes paid	(6,381)	(6,629)
Significant non-cash items:		
Capital-related accruals included in accounts payable	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,	
	2016	2015 (Restated)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 4,898	\$ 2,500
Accounts receivable	207,451	327,123
Allowance for doubtful accounts	(44,477)	(43,755)
Accounts receivable from affiliates	1,984	2,941
Unbilled revenues	54,125	70,683
Inventory	57,566	50,662
Regulatory assets	137,450	122,318
Other	893	701
Total current assets	419,890	533,173
Property, plant and equipment, net	2,745,520	2,482,443
Other non-current assets:		
Regulatory assets	164,023	178,235
Accounts receivable from affiliates	3,219	4,792
Goodwill	396,322	396,322
Other	5,309	5,618
Total other non-current assets	568,873	584,967
Total assets	\$ 3,734,283	\$ 3,600,583

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

BOSTON GAS COMPANY
BALANCE SHEETS
(in thousands of dollars)

	March 31,	
	2016	2015 (Restated)
LIABILITIES AND CAPITALIZATION		
Current liabilities:		
Accounts payable	\$ 57,000	\$ 58,800
Accounts payable to affiliates	43,124	43,687
Current portion of long-term debt	10,000	10,000
Taxes accrued	650	21,059
Customer deposits	4,438	3,198
Interest accrued	7,891	8,249
Regulatory liabilities	40,671	75,494
Intercompany money pool	321,723	255,969
Other	27,777	37,933
Total current liabilities	513,274	514,389
Other non-current liabilities:		
Regulatory liabilities	578,374	544,781
Asset retirement obligations	14,311	15,037
Deferred income tax liabilities, net	488,883	439,853
Postretirement benefits	86,024	97,914
Environmental remediation costs	35,898	39,499
Other	32,065	33,872
Total other non-current liabilities	1,235,555	1,170,956
Commitments and contingencies (Note 12)		
Capitalization:		
Shareholders' equity	1,374,454	1,294,238
Long-term debt	611,000	621,000
Total capitalization	1,985,454	1,915,238
Total liabilities and capitalization	\$ 3,734,283	\$ 3,600,583

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

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

			March 31,	
			2016	2015
			(Restated)	
Total shareholders' equity			\$ 1,374,454	\$ 1,294,238
Long-term debt:				
	Interest Rate	Maturity Date		
<i>Unsecured notes:</i>				
Senior Note	4.49%	February 15, 2042	500,000	500,000
<i>Medium Term Notes ("MTN")</i>				
MTN Series 1995 C	7.10%	October 15, 2015	-	5,000
MTN Series 1994 B	6.93%	January 15, 2016	-	5,000
MTN Series 1994 B	6.93%	April 1, 2016	10,000	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			621,000	631,000
Current portion of long-term debt			(10,000)	(10,000)
Long-term debt			611,000	621,000
Total capitalization			\$ 1,985,454	\$ 1,915,238

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

BOSTON GAS COMPANY
STATEMENT 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	Total Accumulated Other Comprehensive Income (Loss)		
Balance as of March 31, 2014 - restated	\$ 51,418	\$ 962,670	\$ 74	\$ 74	\$ 243,638	\$ 1,257,800
Net income	-	-	-	-	36,431	36,431
Other comprehensive income:						
Unrealized gains on securities, net of \$5 tax expense	-	-	7	7	-	7
Total comprehensive income						36,438
Balance as of March 31, 2015 - restated	\$ 51,418	\$ 962,670	\$ 81	\$ 81	\$ 280,069	\$ 1,294,238
Net income	-	-	-	-	67,456	67,456
Other comprehensive loss:						
Unrealized losses on securities, net of \$9 tax benefit	-	-	(14)	(14)	-	(14)
Total comprehensive income						67,442
Parent loss tax allocation	-	12,774	-	-	-	12,774
Balance as of March 31, 2016	\$ 51,418	\$ 975,444	\$ 67	\$ 67	\$ 347,525	\$ 1,374,454

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 707,000 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 September 2, 2016, 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, 2016.

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 statements of income consistent with the treatment of the related costs in the ratemaking process.

Revenue Recognition

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

With respect to base distribution rates, the 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 rates semi-annually or, based on certain criteria, adjust rates monthly for firm gas sales 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.

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, 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 \$18.6 million and \$16.8 million and gas in storage of \$39 million and \$33.9 million at March 31, 2016 and 2015, respectively.

Derivative Instruments

The Company uses derivative instruments (including options and swaps) to manage commodity price risk. All derivative instruments are recorded in the accompanying balance sheets at their fair value and are included in other current and non-current assets and liabilities in the accompanying balance sheets. All commodity costs, including the impact of derivative instruments, are passed on to customers through the Company's gas cost adjustment mechanism. Therefore, gains or losses on the settlement of these contracts are initially deferred and then refunded to, or collected from, customers consistent with regulatory requirements.

The Company's accounting policy is to 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 in the accompanying balance sheets. There was no related cash collateral as of March 31, 2016 or 2015.

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.
- Not categorized: as discussed in Note 2, under "New and Recent Accounting Guidance," certain investments are not categorized within the fair value hierarchy. These investments are measured based on the fair value of the underlying investments but may not be readily redeemable at that fair value.

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, 2016 and 2015 were 4.2% and 4.4%, respectively. The average service lives for each of the years ended March 31, 2016 and 2015 was 46 years.

Depreciation expense includes a component for estimated future cost of removal, which is recovered through rates charged to customers. Any difference in cumulative costs recovered and costs incurred is recognized as a regulatory liability. When property, plant and equipment is retired, the original cost, less salvage, is charged to accumulated depreciation, and the

related cost of removal is removed from the associated regulatory liability. The Company had cumulative costs recovered in excess of costs incurred of \$575.7 million and \$537.5 million at March 31, 2016 and 2015, respectively.

Allowance for Funds Used During Construction

In accordance with applicable accounting guidance, the Company records AFUDC, which represents the debt and equity costs of financing the construction of new property, plant and equipment. AFUDC equity is reported in the statements of income as non-cash income in other deductions, net, and AFUDC debt is reported as a non-cash offset to other interest, including affiliate interest. After construction is completed, the Company is permitted to recover these costs through their inclusion in rate base and corresponding depreciation expense. The Company recorded AFUDC related to equity of zero and \$0.6 million and AFUDC related to debt of \$0.5 million and \$0.2 million for the years ended March 31, 2016 and 2015, respectively. The average AFUDC rates for the years ended March 31, 2016 and 2015 were 0.7% and 0.3%, respectively.

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, 2016 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, 2016 or 2015.

Available-For-Sale Securities

The Company holds available-for-sale securities that include equities, municipal bonds, and corporate bonds. These investments are recorded at fair value and are included in other non-current assets in the accompanying balance sheets. Changes in the fair value of 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 following table represents the changes in the Company's asset retirement obligations:

	Years Ended March 31,	
	2016	2015
	<i>(in thousands of dollars)</i>	
Balance as of the beginning of the year	\$ 15,037	\$ 15,510
Accretion expense	817	930
Liabilities settled	(1,543)	(38)
Revaluations to present values of estimated cash flows	-	(1,365)
Balance as of the end of the year	<u>\$ 14,311</u>	<u>\$ 15,037</u>

At March 31, 2015, the Company carried out a revaluation study that resulted in a downward revaluation in estimated costs related to its asset retirement obligations. These decreases are the result of changes in remediation costs and enhanced asset replacement programs.

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

Employee Benefits

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

New and Recent Accounting Guidance

Accounting Guidance Adopted in Fiscal Year 2016

The new accounting guidance that was adopted for fiscal year 2016 had no material impact on the results of operations, cash flows, or financial position of the Company.

Presentation of Financial Statements – Balance Sheet Classification of Deferred Taxes

In November 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-17, "Balance Sheet Classification of Deferred Taxes." The new guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance be classified as non-current in the balance sheets; the new guidance does not change the existing requirement of prohibiting the offsetting of deferred tax liabilities from one jurisdiction against deferred tax assets of another jurisdiction. The Company early adopted this guidance, retrospectively, effective April 1, 2015.

Fair Value Measurement – Investments Measured at Net Asset Value ("NAV")

In May 2015, the FASB issued ASU 2015-07, "Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or its equivalent)." The new guidance requires that the valuation of investments using NAV, as a practical expedient to fair value should be excluded from the fair value hierarchy. The Company early adopted this guidance, retrospectively, effective April 1, 2015.

Accounting Guidance Not Yet Adopted

The Company is currently evaluating the impact of recently issued accounting guidance on the presentation, results of operations, cash flows, and financial position of the Company.

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 non-public entities, the new standard is effective for periods beginning after December 15, 2019, with early adoption permitted. The new standard must be adopted using a modified retrospective transition, and provides for certain practical expedients.

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. The new guidance is effective for non-public entities for periods beginning after December 15, 2018, with early adoption permitted for periods beginning after December 15, 2017.

Revenue Recognition

In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers – Deferral of the Effective Date." The new standard defers by one year the effective date of ASU 2014-09 "Revenue from Contracts with Customers (Topic 606)." 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. The new guidance must be adopted using either a full retrospective approach or a modified retrospective approach. For non-public entities, the new guidance is effective for periods beginning after December 15, 2018, with early adoption permitted for periods beginning after December 15, 2016.

Further, in March 2016, the FASB issued ASU 2016-08, which clarifies the implementation guidance on principal versus agent considerations. In May 2016, the FASB issued ASU 2016-12, providing additional clarity on various aspects of Topic 606, including a) Assessing the Collectibility Criterion and Accounting for Contracts That Do Not Meet the Criteria for Step 1, b) Presentation of Sales Taxes and Other Similar Taxes Collected from Customers, c) Noncash Consideration, d) Contract Modifications at Transition, e) Completed Contracts at Transition, and f) Technical Correction. The effective date and transition requirements for the amendments in these updates are the same as the effective date and transition requirements of ASU 2014-09.

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 and net realizable value (other than inventory measured using "last-in, first out" and the "retail inventory method"). The new guidance, which must be applied prospectively, is effective for non-public entities for periods beginning after December 15, 2016, with early adoption permitted.

Intangibles – Goodwill and Other – Internal-Use Software, Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement

In April 2015, the FASB issued ASU 2015-05 “Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement.” The amendments provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The guidance will not change GAAP for a customer’s accounting for service contracts. In addition, all software licenses within the scope of Subtopic 350-40 will be accounted for consistent with other licenses of intangible assets. For non-public entities, the new guidance is effective for annual periods beginning after December 15, 2015, and interim periods in annual periods beginning after December 15, 2016, with early adoption permitted.

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 new guidance, which requires retrospective application, is effective for periods beginning after December 15, 2015, with early adoption permitted.

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. The amendments are effective for the annual reporting period ending after December 15, 2016 and interim periods thereafter.

Financial Statement Restatement

During 2016, management determined that certain accounting transactions were not properly recorded in the Company’s previously issued financial statements. The Company has corrected the accounting by restating the prior period financial statements presented herein, the impacts of which are described below.

During a review of the Company’s open work orders within capital work in progress, management identified charges that were inappropriately classified as capital instead of expense. A cumulative adjustment of \$5.3 million (net of income taxes) was recorded, of which \$2.7 million was recorded as a decrease to opening retained earnings (as of March 31, 2014) and \$2.6 million was recorded as a decrease to net income with the correction recorded within operations and maintenance expense for the years ended March 31, 2015.

In addition, management determined it had incorrectly calculated the Company’s gas cost deferral related to revenue for broker transactions. An adjustment of \$3.2 million (net of income taxes) was recorded as an increase to opening retained earnings (as of March 31, 2014) and a \$3.2 million decrease to net income with the correction recorded with purchased gas, net for the year ended March 31, 2015.

Further, during a review of the Company’s accounting for its unbilled revenue accrual, management identified a gas costs deferral for the year ended March 31, 2014 that had not reversed into the subsequent fiscal year. An adjustment of \$2.9 million (net of income taxes) was recorded as a decrease to net income with the correction recorded within purchased gas, net for the year ended March 31, 2015.

Management also identified an error in the amount of capital-related accruals included in accounts payable, which resulted in an understatement in net cash provided by operating activities and in net cash used in investing activities of \$12.1 million for the year ended March 31, 2015. Other miscellaneous classification errors were also corrected.

Finally, the Company has corrected other miscellaneous account balances that were improperly recorded in the previously issued financial statements. A cumulative adjustment of \$2.4 million (net of income taxes) was recorded, of which \$0.3 million was recorded as a decrease to opening retained earnings (as of March 31, 2014), and \$2.7 million was recorded as an increase to net income for the year ended March 31, 2015.

The following table shows the amounts previously reported as restated:

	As Previously Reported ⁽¹⁾	Adjustments	As Restated
	<i>(in thousands of dollars)</i>		
Statement of Income	March 2015		March 2015
Operating revenues	\$ 1,321,666	\$ 1,878	\$ 1,323,544
Total operating expense	1,211,343	12,886	1,224,229
Operating income	110,323	(11,008)	99,315
Total other deductions, net	(38,727)	1,016	(37,711)
Income before income taxes	71,596	(9,992)	61,604
Income tax expense	29,190	(4,017)	25,173
Net income	42,406	(5,975)	36,431
Statement of Cash Flows	March 2015		March 2015
Net cash provided by operating activities	\$ 161,460	\$ 7,714	\$ 169,174
Net cash used in investing activities	(312,170)	(7,714)	(319,884)
	As Previously Reported ⁽¹⁾	Adjustments	As Restated
	<i>(in thousands of dollars)</i>		
Consolidated Balance Sheet	March 2015		March 2015
Total current assets	\$ 536,271	\$ (3,098)	\$ 533,173
Property, plant, and equipment, net	2,491,337	(8,894)	2,482,443
Total other non-current assets	582,608	2,359	584,967
Total assets	3,610,216	(9,633)	3,600,583
Total other non-current liabilities	1,174,828	(3,872)	1,170,956
Total liabilities and capitalization	3,610,216	(9,633)	3,600,583
Retained Earnings			
March 31, 2015	285,830	(5,761)	280,069
March 31, 2014	243,424	214	243,638
Shareholders' equity			
March 31, 2015	1,299,999	(5,761)	1,294,238
March 31, 2014	1,257,586	214	1,257,800

(1) During 2016, the Company early adopted ASU 2015-17 "Balance Sheet Classification of Deferred Taxes" retrospectively (as discussed in Note 10, "Income Taxes"). This change in accounting policy resulted in the reclassification of balances reported at March 31, 2015.

3. REGULATORY ASSETS AND LIABILITIES

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

	March 31,	
	2016	2015
	<i>(in thousands of dollars)</i>	
Regulatory assets		
Current:		
Derivative instruments	\$ 4,337	\$ 13,435
Gas costs adjustment	102,816	101,067
Revenue decoupling mechanism	18,372	-
Other	11,925	7,816
Total	<u>137,450</u>	<u>122,318</u>
Non-current:		
Asset retirement obligation	9,087	8,270
Capital tracker	10,433	8,713
Environmental response costs	52,402	54,521
Postretirement benefits	76,885	91,070
Regulatory deferred tax asset	14,727	14,952
Other	489	709
Total	<u>164,023</u>	<u>178,235</u>
Regulatory liabilities		
Current:		
Profit sharing	40,671	36,161
Revenue decoupling mechanism	-	39,333
Total	<u>40,671</u>	<u>75,494</u>
Non-current:		
Cost of removal	575,689	537,535
Other	2,685	7,246
Total	<u>578,374</u>	<u>544,781</u>
Net regulatory liabilities	<u>\$ 317,572</u>	<u>\$ 319,722</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: Represents 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 deferred to a regulatory asset to be recovered in future periods, and the non-cash accrual of net actuarial gains and losses. Also included within this amount are certain pension deferral amounts from prior to the acquisition of KeySpan by NGUSA, which are being recovered in rates over a 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 in the accompanying balance sheets 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.

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 related to postretirement benefits, RDM, gas costs and the local distribution adjustment clause, 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 is a total revenue increase of \$44.1 million.

Gas System Enhancement Plan

On April 30, 2015 and April 29, 2016, the DPU approved the Company's 2015 and 2016 GSEP for calendar year 2015 and 2016, respectively, and the associated Gas System Enhancement Factor ("GSEAF"). 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 TIR Program in 2015, however recovery of the revenue requirement 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 \$25.1 million and \$8.3 million for 2016 and 2015, respectively. Also 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.

5. PROPERTY, PLANT AND EQUIPMENT

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

	March 31,	
	2016	2015
	<i>(in thousands of dollars)</i>	
Plant and machinery	\$ 3,407,618	\$ 3,121,850
Land and buildings	63,228	67,887
Assets in construction	117,438	80,435
Software and other intangibles	75,723	75,723
Total property, plant and equipment	<u>3,664,007</u>	<u>3,345,895</u>
Accumulated depreciation and amortization	<u>(918,487)</u>	<u>(863,452)</u>
Property, plant and equipment, net	<u>\$ 2,745,520</u>	<u>\$ 2,482,443</u>

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:

	<u>March 31,</u>	
	<u>2016</u>	<u>2015</u>
	<i>(in thousands)</i>	
Gas purchase contracts	3,056	2,981
Gas swap contracts	<u>17,750</u>	<u>16,710</u>
Total	<u>20,806</u>	<u>19,691</u>

Amounts Recognized in the Accompanying Balance Sheets

	<u>Asset Derivatives</u>			<u>Liability Derivatives</u>	
	<u>March 31,</u>			<u>March 31,</u>	
	<u>2016</u>	<u>2015</u>		<u>2016</u>	<u>2015</u>
	<i>(in thousands of dollars)</i>			<i>(in thousands of dollars)</i>	
<u>Current assets:</u>			<u>Current liabilities:</u>		
Rate recoverable contracts:			Rate recoverable contracts:		
Gas purchase contracts	\$ 63	\$ 48	Gas purchase contracts	\$ -	\$ 205
Gas swap contracts	<u>542</u>	<u>11</u>	Gas swap contracts	<u>4,059</u>	<u>11,560</u>
	<u>605</u>	<u>59</u>		<u>4,059</u>	<u>11,765</u>
<u>Other non-current assets</u>			<u>Other non-current liabilities:</u>		
Rate recoverable contracts:			Rate recoverable contracts:		
Gas swap contracts	<u>23</u>	-	Gas swap contracts	<u>907</u>	<u>1,729</u>
	<u>23</u>	-		<u>907</u>	<u>1,729</u>
Total	<u>\$ 628</u>	<u>\$ 59</u>	Total	<u>\$ 4,966</u>	<u>\$ 13,494</u>

The changes in fair value of the Company’s rate recoverable contracts are offset by changes in regulatory assets and liabilities. As a result, the changes in fair value of those contracts had no impact in the accompanying statements of income. The Company had no derivative instruments not subject to rate recovery as of March 31, 2016 and 2015.

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, applicable payables and receivables, and instruments that are subject to master netting agreements, was a liability of \$9.7 million and \$18 million as of March 31, 2016 and 2015, respectively.

The aggregate fair value of the Company's commodity derivative instruments with credit-risk-related contingent features that are in a liability position at March 31, 2016 and 2015 was \$4.7 million and \$13.5 million, respectively. The Company had no collateral posted for these instruments at March 31, 2016 or 2015. 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 \$5.3 million and \$13.8 million additional collateral to its counterparties at March 31, 2016 and 2015, respectively.

Offsetting Information for Derivative Instruments Subject to Master Netting Arrangements

March 31, 2016 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	\$ 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>
	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 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>

March 31, 2015
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	\$ 48	\$ -	\$ 48	\$ -	\$ -	\$ 48
Gas swap contracts	11	-	11	-	-	11
Total	<u>\$ 59</u>	<u>\$ -</u>	<u>\$ 59</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 59</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 purchase contracts	\$ 205	\$ -	\$ 205	\$ -	\$ -	\$ 205
Gas swap contracts	13,289	-	13,289	-	-	13,289
Total	<u>\$ 13,494</u>	<u>\$ -</u>	<u>\$ 13,494</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,494</u>

7. FAIR VALUE MEASUREMENTS

The following tables present assets and liabilities measured and recorded at fair value in the accompanying balance sheets on a recurring basis and their level within the fair value hierarchy as of March 31, 2016 and 2015:

	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>

	March 31, 2015			
	Level 1	Level 2	Level 3	Total
	<i>(in thousands of dollars)</i>			
Assets:				
Derivative instruments				
Gas purchase contracts	\$ -	\$ 16	\$ 32	\$ 48
Gas swap contracts	-	11	-	11
Available-for-sale securities	537	167	-	704
Total	<u>537</u>	<u>194</u>	<u>32</u>	<u>763</u>
Liabilities:				
Derivative instruments				
Gas purchase contracts	-	143	62	205
Gas swap contracts	-	13,289	-	13,289
Total	<u>-</u>	<u>13,432</u>	<u>62</u>	<u>13,494</u>
Net assets (liabilities)	<u>\$ 537</u>	<u>\$ (13,238)</u>	<u>\$ (30)</u>	<u>\$ (12,731)</u>

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

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

Changes in Level 3 Derivative Instruments

	Years Ended March 31,	
	2016	2015
	<i>(in thousands of dollars)</i>	
Balance as of the beginning of the year	\$ (30)	\$ (10,594)
Total gains or losses included in regulatory assets and liabilities	1,659	(5,142)
Settlements	<u>(1,577)</u>	<u>15,706</u>
Balance as of the end of the year	<u>\$ 52</u>	<u>\$ (30)</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, 2016 or 2015.

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.

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, 2016			Valuation Technique(s)	Significant Unobservable Input	Range
		Assets	(Liabilities)	Total			
<i>(thousands of dollars)</i>							
Gas	Purchase contracts	52	-	52	Discounted Cash Flow	Forward Curve	\$1.9030 - \$1.950/dth
	Total	<u>\$ 52</u>	<u>\$ -</u>	<u>\$ 52</u>			

Commodity	Level 3 Position	Fair Value as of March 31, 2015			Valuation Technique(s)	Significant Unobservable Input	Range
		Assets	(Liabilities)	Total			
<i>(thousands of dollars)</i>							
Gas	Purchase contracts	32	(62)	(30)	Discounted Cash Flow	Unobservable Basis Points	\$1.340 - \$1.740/dth
	Total	<u>\$ 32</u>	<u>\$ (62)</u>	<u>\$ (30)</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, 2016 and 2015 was \$693.2 million and \$730.1 million, respectively.

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

8. EMPLOYEE BENEFITS

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 Plans provide union employees, as well as all non-union employees hired before January 1, 2011, with a retirement benefit. Supplemental non-qualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives. The Pension Plans' costs are allocated to the Company based on plan participant data as determined by the Company's actuaries. The Company contributed \$10.8 million and \$13.8 million for the years ended March 31, 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, 2016 and 2015 was \$16.5 million and \$18.3 million, respectively. KeySpan's unfunded pension obligations at March 31, 2016 and 2015 was \$1 billion. The Company's portion of KeySpan's unfunded pension obligations which are included in postretirement benefits in the accompanying balance sheets at March 31, 2016 and 2015 was an overfunding of \$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, 2016 and 2015, the Company recognized an expense in the accompanying statements of income of \$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 Master Union Trust Plan, the Company's portion is approximately 8% for each of the years ended March 31, 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 \$90.5 million and \$99.3 million at March 31, 2016 and 2015, respectively. These are included in postretirement benefits in the accompanying balance sheets.

Components of Net Periodic PBOP Costs

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

Amounts Recognized in Regulatory Assets

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

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, 2017.

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

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

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>2016</u>	<u>2015</u>
	<i>(in thousands of dollars)</i>	
Change in benefit obligation:		
Benefit obligation as of the beginning of the year	\$ (173,011)	\$ (175,137)
Service cost	(3,244)	(2,886)
Interest cost on projected benefit obligation	(6,745)	(7,400)
Net actuarial loss	10,334	4,729
Benefits paid	8,966	8,869
Actual Medicare Part D subsidy received	-	1
Employer group waiver plan subsidy received	(770)	(1,187)
Benefit obligation as of the end of the year	<u>(164,470)</u>	<u>(173,011)</u>
Change in plan assets:		
Fair value of plan assets as of the beginning of the year	73,680	66,879
Actual return on plan assets	(1,685)	3,092
Company contributions	10,967	12,578
Benefits paid	(8,966)	(8,869)
Fair value of plan assets as of the end of the year	<u>73,996</u>	<u>73,680</u>
Funded status	<u>\$ (90,474)</u>	<u>\$ (99,331)</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 receivable of \$3.2 million and \$4.8 million as of March 31, 2016 and 2015, respectively, for the amount of the unfunded obligation due from these affiliates.

Expected Benefit Payments

Based on current assumptions, the Company expects to make the following PBOP payments subsequent to March 31, 2016:

<i>(in thousands of dollars)</i>	
<u>Years Ending March 31,</u>	
2017	\$ 9,786
2018	10,059
2019	10,227
2020	10,480
2021	10,785
Thereafter	<u>56,722</u>
Total	<u>\$ 108,059</u>

Assumptions Used for Employee Benefits Accounting

	Years Ended March 31,	
	2016	2015
Benefit Obligations:		
Discount rate	4.25%	4.10%
Expected return on plan assets	6.25% - 6.75%	6.25% - 6.75%
Net Periodic Benefit Costs:		
Discount rate	4.10%	4.80%
Expected return on plan assets	6.25% - 6.75%	7.00% - 7.25%

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,	
	2016	2015
Health care cost trend rate assumed for next year		
Pre 65	7.50%	8.00%
Post 65	6.25%	6.50%
Prescription	11.00%	6.50%
Rate to which the cost trend is assumed to decline (ultimate)	4.50%	5.00%
Year that rate reaches ultimate trend		
Pre 65	2025	2022
Post 65	2024	2022
Prescription	2025	2022

Sensitivity to Changes in Assumed Health Care Cost Trend Rates

<i>(in thousands of dollars)</i>	March 31, 2016	
1% Point increase		
Total of service cost plus interest cost	\$	787
Postretirement benefit obligation		8,525
1% Point decrease		
Total of service cost plus interest cost		(657)
Postretirement benefit obligation		(7,363)

The Company expects to make \$7.4 million in contributions to the PBOP plans during the year ending March 31, 2017.

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 target asset allocations for the benefit plans as of March 31, 2016 and 2015 are as follows:

	Pension Plans		PBOP Plans	
	March 31,		March 31,	
	2016	2015	2016	2015
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%	-	-
Real estate	5%	5%	-	-
Infrastructure	3%	3%	-	-
	100%	100%	100%	100%

Fair Value Measurements

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

	March 31, 2016				
	Level 1	Level 2	Level 3	Not Categorized	Total
	<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

	March 31, 2015				
	Level 1	Level 2	Level 3	Not Categorized	Total
	<i>(in thousands of dollars)</i>				
PBOP Assets:					
Cash and cash equivalents	\$ 558	\$ 777	\$ -	\$ 1	\$ 1,336
Accounts receivable	102	-	-	-	102
Accounts payable	(31)	-	-	-	(31)
Equity	9,577	2,721	-	30,898	43,196
Global tactical asset allocation	1,883	-	-	3,687	5,570
Fixed income securities	144	22,806	-	2	22,952
Futures contracts	-	(8)	-	-	(8)
Private equity	-	-	-	559	559
Real estate	-	-	-	4	4
Total	\$ 12,233	\$ 26,296	\$ -	\$ 35,151	\$ 73,680

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 in the same category as the investments to which they relate. 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 are classified as Level 2 investments. Investments in commingled funds with redemption restrictions and that use NAV 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, 2016 and 2015, the Company had accrued workers compensation, auto, and general insurance claims which have been incurred but not yet reported of \$13.5 million and \$12.6 million, respectively.

9. CAPITALIZATION

The aggregate maturities of long-term debt for the years subsequent to March 31, 2016 are as follows:

<i>(in thousands of dollars)</i>	
<u>Years Ending March 31.</u>	
2017	\$ 10,000
2018	8,000
2019	20,000
2020	7,000
2021	5,000
Thereafter	571,000
Total	<u>\$ 621,000</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, 2016 and 2015, the Company was in compliance with all such covenants.

10. INCOME TAXES

Components of Income Tax Expense

	Years Ended March 31,	
	2016	2015
	<i>(in thousands of dollars)</i>	
Current tax expense (benefit):		
Federal	\$ (382)	\$ 11,396
State	2,598	8,906
Total current tax expense (benefit)	<u>2,216</u>	<u>20,302</u>
Deferred tax expense (benefit):		
Federal	37,645	8,798
State	6,532	(3,920)
Total deferred tax expense (benefit)	<u>44,177</u>	<u>4,878</u>
Amortized investment tax credits ⁽¹⁾	-	(7)
Total deferred tax expense (benefit)	<u>44,177</u>	<u>4,871</u>
Total income tax expense	<u>\$ 46,393</u>	<u>\$ 25,173</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, 2016 and 2015 are 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,	
	2016	2015
	<i>(in thousands of dollars)</i>	
Computed tax	\$ 39,847	\$ 21,561
Change in computed taxes resulting from:		
State income tax, net of federal benefit	5,934	3,222
Investment tax credits	-	(7)
Other items, net	612	397
Total	<u>6,546</u>	<u>3,612</u>
Total income tax expense	<u>\$ 46,393</u>	<u>\$ 25,173</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.

On August 26th IRS issued Revenue Procedure 2016-48 that enables the Company to claim prior year's unclaimed bonus depreciation in its federal income tax return for the period ended March 31, 2016. As a result of the adoption of this procedure, the Company will increase its other long term liability and reduce its deferred tax liability by \$5 million in the next fiscal year.

Deferred Tax Components

	March 31,	
	2016	2015
	<i>(in thousands of dollars)</i>	
Deferred tax assets:		
Allowance for doubtful accounts	\$ 19,125	\$ 18,815
Environmental remediation costs	15,436	17,593
Future federal benefit on state taxes	24,982	22,153
Postretirement benefits and other employee benefits	58,578	62,914
Regulatory liabilities - other	26,079	24,497
Net operating losses	24,151	-
Other items	17,399	12,512
Total deferred tax assets ⁽¹⁾	<u>185,750</u>	<u>158,484</u>
Deferred tax liabilities:		
Property related differences	537,787	491,026
Regulatory assets - deferred gas costs	66,474	48,819
Regulatory assets - environmental response costs	21,924	23,444
Regulatory assets - postretirement benefits	27,735	27,949
Other items	20,713	7,099
Total deferred tax liabilities	<u>674,633</u>	<u>598,337</u>
Deferred income tax liabilities, net	<u>\$ 488,883</u>	<u>\$ 439,853</u>

⁽¹⁾ The Company established a valuation allowance for deferred tax assets in the amount of \$0.4 million related to expiring charitable contribution carryforwards at March 31, 2016. There was no valuation allowance for deferred tax assets at March 31, 2015.

As a result of retrospective adoption of ASU 2015-17, the Company adjusted its current portion of deferred income tax assets and non-current deferred income tax liabilities, net by \$6.3 million as of March 31, 2015.

Net Operating Losses

The following table presents the amounts and expiration dates of net operating losses as of March 31, 2016:

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	78,987	19,912

Unrecognized Tax Benefits

As of March 31, 2016 and 2015, the Company's unrecognized tax benefits totaled \$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 in the accompanying balance sheets.

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

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

As of March 31, 2016 and 2015, the Company has accrued for interest related to unrecognized tax benefits of \$2.1 million and \$1.5 million, respectively. During the years ended March 31, 2016 and 2015, the Company recorded interest expense of \$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, 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. During the period, the IRS commenced its next examination cycle which includes income tax returns for the years ended March 31, 2010 through March 31, 2012. The examination is not expected to conclude until December 2017. The income tax returns for the years ended March 31, 2013 through March 31, 2016 remain subject to examination by the IRS.

The Massachusetts unitary state income tax returns for the years ended March 31, 2010 through March 31, 2016 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, 2016 and 2015 were \$4.8 million and \$3.7 million, respectively.

Upon the acquisition of KeySpan by NGUSA, the Company recognized its environmental liabilities at fair value. The fair values included discounting of the reserve, which is being accreted over the period for which remediation is expected to occur. Following the acquisition, these environmental liabilities are recognized in accordance with the current accounting guidance for environmental obligations.

The Company estimated the remaining costs of environmental remediation activities were \$35.9 million and \$39.5 million at March 31, 2016 and 2015, respectively. The Company's environmental obligation is discounted at a rate of 6.5%; the undiscounted amount of environmental liabilities at March 31, 2016 and 2015 was \$49.1 million and \$55.9 million, respectively. These costs are expected to be incurred over approximately 55 years, and the discounted amounts have been recorded as reserves in the accompanying balance sheets. However, remediation costs for each site may be materially higher than estimated, depending on changing technologies and regulatory standards, selected end use for each site, and actual environmental conditions encountered. The Company has recovered amounts from certain insurers and 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, 2016 and 2015, the Company has recorded environmental regulatory assets of \$52.4 million and \$54.5 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 \$17.2 million and \$14.9 million for the years ended March 31, 2016 and 2015, respectively.

The future minimum lease payments for the years subsequent to March 31, 2016 are as follows:

<i>(in thousands of dollars)</i>	
<u>Years Ending March 31.</u>	
2017	\$ 1,542
2018	1,491
2019	1,266
2020	1,289
2021	1,312
Thereafter	<u>10,264</u>
Total	<u><u>17,164</u></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, 2016 are summarized in the table below:

<i>(in thousands of dollars)</i>	<u>Years Ending March 31.</u>	
	Gas	Capital Expenditures
2017	\$ 145,677	\$ 25,549
2018	115,650	-
2019	79,594	-
2020	62,261	-
2021	40,738	-
Thereafter	<u>205,770</u>	<u>-</u>
Total	<u>\$ 649,690</u>	<u>\$ 25,549</u>

Legal Matters

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

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:

	Accounts Receivable from Affiliates		Accounts Payable to Affiliates	
	March 31,		March 31,	
	2016	2015	2016	2015
	<i>(in thousands of dollars)</i>			
Colonial Gas Company	\$ -	\$ -	\$ 4,511	\$ 17,301
KeySpan Corporation	-	-	17,887	22,126
National Grid Electric Services, LLC	-	-	291	293
National Grid Engineering Services, LLC	1,851	1,111	-	-
National Grid Generation LLC	111	-	-	-
NGUSA Service Company	-	-	18,951	2,013
Niagara Mohawk Power Corporation	-	1,699	88	-
Other	22	131	1,396	1,954
Total	\$ 1,984	\$ 2,941	\$ 43,124	\$ 43,687

At March 31, 2016 and 2015, the non-current portion of accounts receivable from affiliates represents the PBOP liability of \$3.2 million and \$4.8 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 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 \$321.7 million and \$256 million at March 31, 2016 and 2015, respectively. The average interest rates for the intercompany money pool were 0.7% and 0.3% for the years ended March 31, 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 from the service companies of NGUSA to the Company for the years ended March 31, 2016 and 2015 were \$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 effect on net income would be \$2.6 million and \$3.8 million before taxes and \$1.6 million and \$2.5 million after taxes, for the years ended March 31, 2016 and 2015, respectively, if these amounts were allocated to the Company.