Network Rail Infrastructure Limited
Annual Report and Accounts 2011

*"I hope we'll have more trains that will cost less to travel on."**

Reducing the cost of our railway is one of our main priorities and we're targeting £5bn of savings over the five years to 2014. We're also investing £12bn in projects and schemes aimed at increasing the capacity of the network – more, longer, quicker trains.

**Passenger comment, May 2011*

Helping Britain run better

Contents

Network Rail is moving away from centralisation, creating 10 regional operations with responsibility and accountability for their routes. Staff on these routes will work openly with train operators and passengers to deliver a railway that costs less and that people choose to use.

Foreword

This report covers the second year of Control Period 4, the quinquennial settlement running to 2014. It is also the first report for David Higgins, Network Rail's Chief Executive who started on 1 February 2011.

The story of Control Period 4 is one of sustained investment in renewing and improving Britain's railway. Network Rail is investing in Britain's railway to reduce delays and to run more and longer trains. This investment will increase the capacity of the railway to support the drive to accommodate the growth in passenger numbers.

Network Rail is also investing to shorten journey times, improve Britain's stations and make the railway even more reliable. Significant milestones in the past year include the completion of the Airdrie to Bathgate railway in Scotland and the opening of a new station at Newport, Wales, in time for the Ryder Cup.

In a departure from previous years, David Higgins has made the online Annual Report his primary focus and this year his review takes the form of a video interview, transcribed for the printed version.

What has not changed is Network Rail's relentless focus on efficiency, brought into sharper focus by the Government's review, chaired by Sir Roy McNulty, of the cost and efficiency of Britain's railway. A key element in reducing costs is Network Rail's recent drive to devolve accountability and decision-making, putting them closer to the customer.

Innovation, investment and a focus on improving efficiency are ongoing themes of Control Period 4 and this Annual Report.

"The railway should be more accessible as fuel costs are rising. We need to encourage more people to use the railways and we can only do that through investment."*

Delivering a safe, punctual, bigger and better railway continues to be our focus but of increasing importance is the cost. We reduced the running costs of the railway by over £400m in the last year and by around £600m since 2009.

**Passenger comment, May 2011*

Chairman's statement

All change at Network Rail

This year has been one of the most significant in Network Rail's short history. During 2010/11 the Company experienced a change of Government, a change of Chief Executive and a change of corporate ethos.

At the same time, Network Rail continued to run effectively one of the world's busiest and most complex railway networks, whatever the vagaries of weather or the slings and arrows of outrageous fortune. This is an achievement that should not be underestimated. Despite the potential for distraction, Network Rail has focused on its core operations and delivered a solid operating performance, both in terms of running a safe and reliable rail network and continuing to reduce costs and drive efficiencies. That said, we recognise that we can and must improve still further to meet the expectations of funders and users. David Higgins, Network Rail's new Chief Executive and Patrick Butcher, the Group Finance Director provide details of the Company's operating and financial performance in their reviews as well as a statement of our ambitions.

The focus for my statement is the significant changes that have occurred during the past 12 months, notably the change of Chief Executive Officer. I would like to pay tribute here to the outstanding job that Iain Coucher did for Network Rail. It is easy to forget the grim situation that faced Britain's railway at Network Rail's inception. Railtrack was in administration. One in four trains was late. The West Coast modernisation project was much delayed and costs had spiralled. The performance and reputation of the railway was at an all time low. The contrast with the situation at Iain's departure could not be clearer. Nine out of ten trains run on time. The West Coast upgrade that Network Rail inherited was delivered on time as promised. Maintenance, one of Network Rail's core functions, is now delivered in-house. Passenger numbers and satisfaction levels are at an all time high. Britain's railway has been transformed and Iain Coucher, as Deputy Chief Executive and latterly as Chief Executive, played a pivotal role.

The Board was delighted to appoint a highly capable and qualified replacement in David Higgins. His track record is exceptional, encompassing chief executive roles in both the public and private sector. In addition, his experience as a Non-Executive Director of Network Rail gave him the head start that has allowed some significant early decisions, such as the devolution project which will empower decision-making at a local level and drive closer alignment between route level infrastructure management and the train and freight operators.

In last year's report, I highlighted the need to start to win emotional battles and improve relationships. I am pleased to report some real progress, albeit hard won, in this area. Our priority has been our relationship with Governments. The Board of Network Rail has tempered its strict adherence to a private company philosophy and instead adopted a more balanced approach which properly recognises the important role of Governments in funding Britain's railways and creating a constructive context for financing from other sources. This is not to say that Network Rail has become the rail equivalent of the Highways Agency, rather it is about listening positively to the Governments in England, Scotland and Wales and recognising their status as both investors in the railway and political representatives. Across Britain, national and local government has recognised the importance of sustained public investment in rail. The railway is a vital part of the nation's social and economic infrastructure and is crucial to the country's ability to compete for investment and markets. Last year's Comprehensive Spending Review, which left Network Rail's regulatory settlement largely untouched, was a clear demonstration of the Government's commitment to Britain's railway.

At the same time, the Government also recognised that the structure of Britain's railways was potentially an impediment to efficiency and established the 'Rail – value for money study', a review chaired by Sir Roy McNulty. The final report made a series of recommendations on how the railway can be made more efficient with a reduction of the burden of support required from the public purse. The key recommendations are centred around top level leadership of the industry, clear cost reduction objectives and benchmarking, structural changes and effective incentivisation. The study identifies a significant efficiency gap between the rail industry in Britain and leading international comparators and will make a number of specific recommendations to improve efficiency.

We had long anticipated the major structural change recommendation that relates to Network Rail was likely to be that of decentralisation and a transfer of decision-making to those parties who operate the network at levels that are closest to the market. David Higgins has already moved to take action on this front through the devolution project. In addition, our new approaches to partnering and contestability of our services will continue to drive a fast pace of change within both the Company and the industry as a whole.

The Board has given its full backing to Sir Roy and Network Rail has played an active and energetic role in the review. Crucial to enabling this role has been the fact that the Board has been open to all outcomes from the study and committed to the best possible outcome for the users, funders and industry. We have approached the review objectively, with the shared goals of driving further efficiency and cutting costs. We have been tireless in our attempts to dismantle some of the barriers to progress that have emerged over the years.

Recruiting and retaining top talent is a vital part of achieving our very ambitious goals. There is no doubt that the market for outstanding executives is now global and very active. In recent months, Network Rail has lost route senior staff to transport networks in Australia and the Middle East. Closer to home, senior Network Rail staff have joined both Crossrail and HS2. These circumstances, together with recognition of legitimate concerns from Government, the regulator and other stakeholders, resulted in our review and consequent revision of the Company's remuneration and incentive schemes. Full details appear later in this report, but I would like to give thanks to both Steve Russell for his tireless work in shaping the scheme and to Members for their high levels of engagement when endorsing the schemes. By delivering an approach that rewards only long-term outperformance, I am confident that we have a robust model that will drive the right behaviours and incentivise success, while allowing us to be competitive in the global battle for talent.

Over the year, the planned reshaping of the Board has reached completion. David Bailey stood down in November 2010 while Yvonne Constance and Chris Green retired at the AGM in July last year. I would like to express my thanks for their contribution and formally welcome Malcolm Brinded and Bridget Rosewell who joined in the year. We will also welcome Keith Ludeman to the Board in July 2011.

Last year, I also noted progress in our primary governance and the assessment of the Company's future challenges. This year we have focused on leadership culture, flows of communication and quality of dialogue, scrutiny and assurance. We have made real progress in all areas and I am confident that the changes we have made at Board level and through devolution and other initiatives will sustain this momentum.

Finally, I would like to put on record the Board's appreciation of the efforts of all Network Rail's people in running Britain's rail network in what has been a year of significant change. The dedication and commitment of our people to keeping the railway running, notably in terrible winter weather is worthy of the highest praise. These qualities, together with the actions the Board has taken in the past year, give me confidence that Network Rail will deliver a strong performance in the year ahead.

Rick Haythornthwaite
Chairman
8 June 2011

Chief Executive's review

David Higgins joined Network Rail in April 2010 as a Non-Executive Director, and became Chief Executive on 1 February 2011. Here he reviews the last year and considers the challenges to come.

You have been in position for just over four months. What are your first impressions?
My first impressions are the sheer scale of this business, the complexity of Network Rail and the level of public interest from passengers and people who live alongside our track. Then there's the public spotlight, it's very intense with a lot of political focus on our performance. It's also a business with a long-term strategic outlook, but a need to deliver an effective operation all day, every day.

Let's look at the Company's performance over the past year – what are the highlights? And what needs more attention?
For me one of the really big highlights this year has been the restructuring of the maintenance operation. We have worked very closely with our colleagues in the trade unions to overhaul old, outdated agreements which were inherited from the various private companies when we brought back maintenance in house. For example, we had over 500 different job classifications. We have standardised and streamlined these, allowing us to make productivity improvements across our whole workforce. The restructuring allows us to be more competitive and productive.

As a result, over the next few years we will see big improvements in our cost efficiency. What you will see in this year's Annual Report is that we have had a good year. We have outperformed our target for cost efficiency, which is absolutely crucial for achieving our objectives for the control period finishing in 2014.

On the other side, what hasn't been good this year has been the operational performance of the network for our customers. We had a tough winter – the worst for 40 years. Winter started very early, which meant that we missed all our public performance measures for the year. We need to learn how other countries in Europe deal with that level of heavy snow, we need to work closer with our customers to be more prepared and we need to communicate better with the public as they wait on platforms or on trains to find out what is going on. Good information is vital for passengers.

Network Rail has always said that the Office of Rail Regulation's (the ORR) targets for the Company for CP4 will be tough – what progress are you making, especially on the key issue of finding £billions of efficiencies?
The targets that the ORR set us for the control period that finishes in March 2014 are tough. I said that when I first joined the organisation as a Non-Executive Director, and I reinforce it now. Those targets on delay minutes, on public performance measure and on cost are hard to achieve. We have set ourselves the challenge of achieving them and we must remain focused. We are on the right track for the public performance and cost targets, but we need to catch up on network availability. We have made good progress on cost efficiency, but we could lose all those gains in the last three years if we don't stay focused.

The key ways we are making efficiencies during this five year control period are on our operations and maintenance costs and by investing in operational technology. But on renewals, one of the biggest areas for improvements, our targets are particularly tough.

One of the big challenges in renewals is 'when do we need to renew?' – particularly with reference to track. We have to decide whether to extend the life of our assets or renew them and which offers better value for money. To make these decisions we need high quality asset information. We are getting better in this area – both in the quality of data and our understanding of it. As we improve, we will make better decisions about the condition of our assets and get the best lifetime value from them without impacting public safety.

The McNulty report on value for money on rail has now been published – what do you make of its conclusions and what changes will you be making at Network Rail as a result?

The conclusion of the McNulty report is that our industry is fragmented and lacks leadership, and because of this we are inefficient compared to international benchmarks. The report sets out a roadmap of how the industry can improve by removing the current processes which result in conflict and lack of alignment. It challenges the whole industry to take a leadership role in meeting international benchmarks.

"Network Rail is state owned, isn't it?"*

Network Rail is a private company, with 100 Members rather than shareholders, we are acutely aware of the vital public service it provides to around four million daily users. Our ethos is one of openness, transparency, accountability and responsiveness.

**Passenger comment, May 2011*

At Network Rail we have to look at everything we do, we need to open up our supply chain and projects to competition, to challenge our cost structures, and we need to get much closer to our customers. Devolution at Network Rail is empowering our regional managers and transferring decision-making to the people who know their area best. This will give greater opportunities to match those international benchmarks.

The history of the railway is littered with reports and restructures that have rarely delivered all they promise – why should McNulty and devolution be any different?

As I've already said, the key to Sir Roy's report is that we are a fragmented industry and there is a lack of leadership, with no real strategic drive from inside the industry itself. Therefore the industry has to take control of its own destiny and then drive for efficiency.

There have been a lot of reports before. The key to this report, in my opinion, is the way that it has been prepared. There has been extensive consultation and we understand how the report has come to its conclusions. Those conclusions are ultimately all about leadership.

You seem to have pre-empted McNulty by forging ahead with 'devolution' – what is it and why is it so important?

The challenges that McNulty has set us are to be more efficient and to co-operate more fully with our customers. Devolution is all about working with our routes and putting more decision-making right at our customer interface – with regional managers. They will take the decisions on how we maintain the network in their areas, how we upgrade it, how we work to minimise disruption for the seven day a week railway, and also how we enable integration at route level.

Devolution is also about the quality of our people and their commercial and leadership skills. It's about engagement, relationships with our customers, our supply chain and our communities, our ability to set simple targets – and it's about leadership.

Of course to achieve this we have to work much closer with our train and freight operating customers. What they want is much closer engagement with us and to know that the people they are dealing with have the authority to make decisions and take control over the resources they need to implement their decisions.

Less heralded than devolution, you have signalled a new approach to major projects and suppliers – what's the thinking behind this approach?

All my experience in the UK and overseas is that your relationship with your suppliers (that is designers, contractors and manufacturers), is absolutely crucial in delivering major projects. At Network Rail we are too traditional. We have involved these organisations too late in the process of delivering major projects. My experience from the Olympics tells me that we need to engage with our suppliers much earlier. We should recognise and use their skills, and complement our expertise with theirs. This is about trust and respect, and making sure we have people with the right skills within our organisation who can deliver a clear brief to our suppliers.

We've got an enormous number of projects underway at any one time and the really big projects like Crossrail and Thameslink get most of the focus. They get our best people. They are critical in terms of the key blockades, and we do a fantastic job. But there are numerous smaller projects across the whole network. To deliver these to the same standard we need a much greater involvement of our supply chain to streamline and standardise our procurement, and to get consistency across our huge work programme.

The prize for us and our industry is efficiency. All the benchmarking tells us our work is more expensive in the UK than in Europe. There are many reasons for that – for example, our design process is slower. Our procedures, our standards, our external reviews and the various approvals we have to go through are more complicated. Access to our track is more limited. We must work smarter. We have to work with our customers to get quicker track access so we can drive down the costs of major projects and renewals.

In February, the Rail Safety & Standards Board (RSSB) published its findings on Network Rail's safety reporting – this didn't pull its punches, what are you doing to change safety culture?

The RSSB's report was very blunt, showing that there was under-reporting of safety incidents consistently over a number of years, particularly minor incidents. There are many reasons why that happened, but we have to have a behavioural change in our organisation on safety.

Safety can no longer be something that is separate. Safety must be fundamental in everything we do – from the way we make decisions, to the way we review projects, and to how we design the railway. The senior leadership must make the right decisions and we must get the skills and culture right too. Front line supervisor training and safe design are crucial in improving safety in our organisation.

Pay and bonuses have also been a difficult issue for the Company, how can you improve matters?

Pay and bonuses are always a challenge for any organisation that gets public funding, and it has been a challenge here at Network Rail. We are going to improve that through transparency. Successful performance must be obvious and objectives must be clear and about performance. The public, our Members and the politicians must know what those objectives are. That said, performance pay is absolutely crucial to get better productivity in any organisation.

Our challenge is to attract the right people. It is a very active marketplace – if you look at our senior executive team, most people have come from the private sector. People are very mobile, they are mobile both in the UK and internationally, so you have to have competitive packages to attract and retain the right executives. But because we are publicly funded, we must be accountable and justifiable to the public.

"We need more and longer trains, then there wouldn't be punctuality problems."*

The railways have never been more popular. The result is that we need more capacity. More trains and longer trains. We spent £1.7bn in the year on increasing capacity and plan to invest £12bn over the five years to 2014.

**Passenger comment, May 2011*

Look at the pay deal we have just done with our operating staff covering thousands of people who run our network. It is quite similar to the deal we did a while ago with our maintenance staff. It offers Retail Price Index (RPI) plus half a per cent. For 2010, that meant that our workforce got about 0.8 per cent increase. This year it means that they will get about 5.2 per cent. What is crucial to both deals is productivity improvements, so the overall cost of our organisation in both areas goes down each year of this control period.

In 2012 the Olympics will be a huge operational challenge for us and for our industry. We have agreed we won't have disputes for a period in the lead up to and after the Games. Anything that is a concern will be deferred until after the Games. No-one wants disruption. We don't want it, and certainly the trade union movement doesn't want it either. This is a good deal for the Company and the country.

Finally, in 12 months time what do you expect to be reflecting on?

The next 12 months for both Network Rail and me personally, is an absolutely crucial year. The big initiatives that have just started will be well advanced – devolution of our routes, the establishment of our projects business as more independent and more contestable. Moving forward quickly will be tough and challenging, but our organisation is ready.

From a personal perspective, I always like a challenge. I have already discovered that with this job there are some major challenges and this is what I thrive on. I am looking forward to the challenges. I am looking forward to working in an industry which has a lot of passionate people. It's a great business to be involved in.

David Higgins
Chief Executive
8 June 2011

Group Finance Director's review

This Annual Report marks the end of the second year of Control Period 4. This year saw Network Rail continue to reduce its running costs, and we remain on target to achieve the challenging efficiency savings first set out in our CP4 Delivery Plan in 2009. In real terms, over £400m has been taken out of running costs in the year, and around £600m since the start of this regulatory period.

Financial highlights

For the year ended 31 March 2011	2011 £m	2010 £m
Revenue	**5,712**	5,668
Operating profit	**2,028**	1,981
Profit after tax	**313**	284
Net cash from operating activities	**2,486**	2,234
Net debt	**(25,049)**	(23,838)
Net assets	**7,689**	6,555
Railway network fixed assets	**39,577**	36,629
Value of investment property	**778**	764
Capital expenditure	**3,997**	3,920

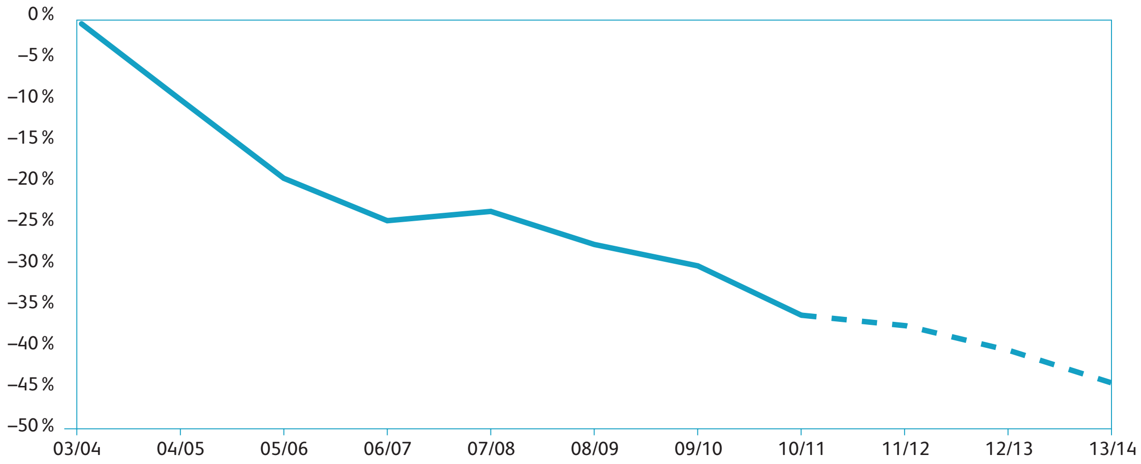
The comprehensive spending review reaffirmed that governments in both Westminster and Holyrood continue to see investment in rail as a driver of economic well-being and a contributor to sustainable economic development. The findings of the Government-commissioned McNulty value for money study also show that there are clear opportunities for the whole rail industry to make further savings in the costs of the railway. The message is clear: the rail industry simply has to become more affordable for the users of the railway network and for tax payers.

Part of building closer relationships with customers and stakeholders is making sure that they share in any outperformance of the regulatory settlement by Network Rail. This year Network Rail was able to repay more than £100m via reduced access charges from outperformance to our customers. (Outperformance occurs when Network Rail saves even more money than agreed as part of the regulatory settlement.)

Progress to achieving the efficiencies set out in the CP4 Delivery Plan

Network Rail continues to make sound progress against the CP4 Delivery Plan. The Plan was Network Rail's response to the five year regulatory settlement. It sets out how Network Rail would achieve the outputs required using the funding available, whilst achieving at least the reduction in running costs required by the regulatory settlement.

Production and runnings costs 2003 to 2014



Network Rail produces an annual delivery plan update, the most recent being published in February 2011. This confirmed that Network Rail remains on course to achieve all of its regulatory outputs and that opportunities exist to outperform the financial targets.

The Real Economic Efficiency Measure (REEM) records how the running costs of the railway have decreased. This is calculated after adjusting for inflation, and by comparison to the base year 2008/09. It shows that our running costs for the year are, in real terms, 13.0 per cent lower than in 2008/09, and 9.7 per cent lower than last year.

The definition of the measure is agreed with the ORR; they have yet to finally agree the percentages.

Our CP4 Delivery Plan requires us to achieve efficiencies of 23 per cent by 2013/14. If we achieve this target, then, over a 10 year period we will have reduced costs by over 44 per cent in real terms.

Value for money

Another way of describing the impact of savings Network Rail has made, and plans to make over the next few years, is by considering the total operating and maintenance costs per train mile (see graph below), and how these have decreased over the last seven years.

Operating costs, including maintenance expenditure have fallen significantly in real terms in the last seven years, whilst at the same time the network has become busier. As a result, costs per train mile have fallen from £11.64 to £7.61 per train mile. In the last year, costs per train mile fell by 77p, and are expected to continue to fall over the next few years.

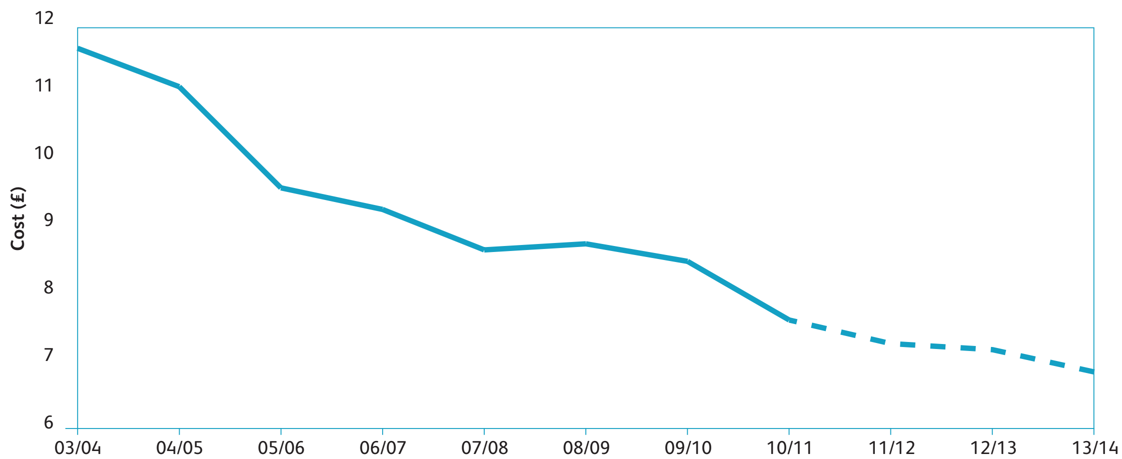
Asset stewardship

Network Rail has made significant efficiencies in both its renewals and maintenance activities. It is vital that these savings are not made at the expense of the quality of the assets that comprise the railway network.

Network Rail uses the asset stewardship indicator to assess the quality of its assets. The measure helps to demonstrate that cost efficiencies have been made in a sustainable way.

The asset stewardship indicator includes over 20 separate measures, which record both the condition and performance of the Group's key infrastructure assets. The measure exceeded target for the year, reaching 0.067, an improvement on last year (2010: 0.032). This improvement was due to reducing levels of serious rail defects, and improvements in the robustness of signalling and telecom assets.

Real operating costs per train mile (£) (2010/11 prices)



Financial review of the year

Revenue

Network Rail generates passenger franchise revenue, revenue grants, freight income, property rental income and open access income from its operations.

Turnover was largely in line with the expectations set out in the delivery plan and broadly similar to last year at £5,712m (2010: £5,668m). The majority of Network Rail's income comes from fixed track access charges and the revenue grant. These charges are set by the independent rail regulator and are largely fixed across the five year regulatory settlement.

Key variable income flows relate to the performance regime and property income.

Performance regime

Train performance was badly affected by the severe weather during November and December 2010. The performance regime penalises Network Rail when the railway is not available for use, and this affected the income received from train operators and freight customers.

*"I commute in the morning and it's bedlam in rush hour as there are so many people trying to get through."**

Network Rail is redeveloping stations across the country. The redevelopment of Birmingham New Street for example, will open up the city, help regenerate the local area and provide a stunning new building for Birmingham. A similar project at London King's Cross is underway and due to be finished by next Spring.

**Passenger comment, May 2011*

This cost Network Rail over £50m this year and, when aggregated with incentives around minimising disruption caused by infrastructure works, resulted in a fall in performance related income and expense from £42m (income) in 2009/10 to £14m (expense) in 2010/11.

During 2010/11, better planning and rephasing of work resulted in fewer disruptive possessions saving more than £51m when compared to the cost assumed in the CP4 Delivery Plan. There is still a significant amount of the investment programme to be completed over the next three years, and it is crucial that we continue to work with train operators and freight customers to minimise disruption.

Property

Property rental income, mainly from small and medium-sized businesses, and retail tenants at the major stations, produced better returns in the year, up £38m to £244m. Retail income at stations performed particularly well, beating the trend on the high street and in major shopping centres.

Property sales were £12m (2010: £nil). The investment properties valuation grew by £14m as a result of investment in this class of properties.

Operating and maintenance costs

Because Network Rail's income is largely fixed, achieving or out performing regulatory targets requires cost reductions. This includes ensuring that marginal costs are exceeded by marginal income.

Operating costs are difficult to reduce, as a large proportion of these are relatively fixed. In the year operating costs, excluding depreciation, fell to £2,467m from £2,546m. This includes staff costs that fell in the year to £1,734m (2010: £1,746m). This was despite average salaries rising by 1.5 per cent because these were absorbed by headcount reductions. Average staff numbers fell from 37,153 to 35,606 in the year.

Reducing maintenance costs

The maintenance team built on last year's solid performance with further efficiencies during 2010/11. This has been achieved through a major reorganisation that allowed for the standardisation and optimisation of maintenance delivery, and improved the usage of unit cost information.

By better planning of works and better use of possessions, the maintenance team have been able to reduce costs. This includes better planning and control over overtime working. Overtime payments fell from £27m to £23m in the year. The reduction also includes increased productivity as the team delivered maintenance activities at lower unit rates.

New technologies and capital investment played a major part in reducing costs.

For example, Network Rail purchased vegetation cutters and mounted them on road rail vehicles to undertake vegetation clearance. In a single shift the mechanical cutters clear over six times as much vegetation for 30 per cent of the cost compared to using hand held chainsaws.

Renewals

Network Rail is tasked by the Office of Rail Regulation (the ORR) to maintain the quality of its assets, including stations and network capability, and to do so at an increasing level of efficiency. Network Rail considers the key to success to be the development of asset policies which help reduce whole-life costs while continuing to improve asset condition.

In the year, asset condition (as measured by the asset stewardship indicator) improved and levels of investment remained high. These were delivered more efficiently than last year and in comparison to the CP4 Delivery Plan.

Network Rail invested £2.2bn (2010: £2.2bn) in the year on renewing the railway network, including £0.6bn on track.

Repeatable items such as the renewal of the existing network form a key part of the efficiency challenge. Network Rail has been able to drive circa 16 per cent reduction in real terms in the cost of renewals over the last two years. This reduction is made up of five per cent volume efficiency, six per cent from measurable unit costs and a further five per cent from other cost reductions.

This has been achieved by implementing revised asset policies and route asset management plans, introducing smarter working practices, and investment in equipment that enables us to carry out tasks faster, with less disruption and at a lower cost.

Asset management plans aim to provide the most efficient whole-life cost after taking into account route asset management policies. These plans define the maintenance and renewal work required to produce sustainable route outputs for the level of funding available.

Smarter working practices include the use of modular designs, which enable off-site construction. This saves money, requires shorter more predictable possessions and is inherently safer than traditional build methods.

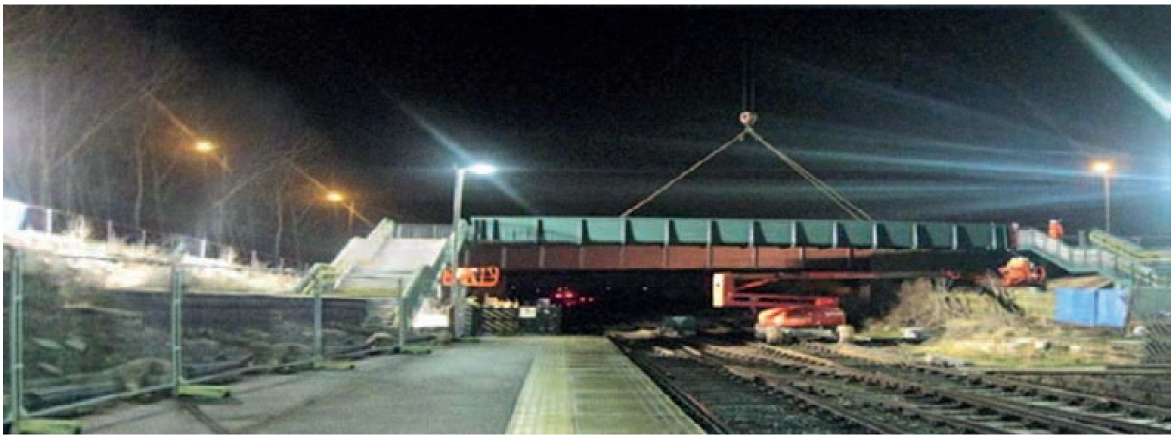
The picture below shows the modular footbridge at Moorthorpe. The bridge was constructed off-site before being lowered into position. The project came in under budget and contributed to renewal efficiencies.

Another example of modular designs are the switch and crossing units which are factory assembled, tested and shipped to site ready to install without subsequent dismantling and reassembling.

This technology is expected to reduce the average replacement time for switches and crossings from 54 hours to eight hours, over the next three years. This will not only be more cost effective, but will increase network availability and reduce disruption.

High output plant optimisation

By optimising the use of high output plant, such as the track laying machine (see page 13) we have been able to drive further efficiencies which are evidenced by reduced track unit costs (plain line unit costs fell by 6.5 per cent in the year, and switches and crossings renewals by 16.6 per cent). Such plant reduces the time it takes to replace track which increases network availability and reduces disruption to users of the railway.



Modular footbridge at Moorthorpe

Enhancements

Network Rail continues to expand the railway network to meet the increased demand from rail users. Rail travel has never been more popular and capacity is becoming a constraint in some locations. The Comprehensive Spending Review has reconfirmed the vast majority of the enhancement programme set out in the regulatory settlement. Due to the current economic climate there has been some deferral of work into the next regulatory period, and some third party funded schemes have been cancelled.

Network Rail expects to spend around £12bn on enhancing the network across the control period, and this year spent £1.7bn on enhancements. This was £0.9bn less than planned largely because work was deferred to future years. However, we expect to meet all but five (one per cent) of the expected implementation dates for schemes that form part of the regulatory settlement. Schemes developed outside of the regulatory settlement, including third party enhancements, have been subject to the most change, due to the current economic climate and the impact of the comprehensive spending review on third party funders. Our latest delivery plan update reduced expenditure on such enhancements by £1.1bn over the remainder of the five year regulatory period.

"The more freight is carried by trains the better. It keeps lorries off the road, eases congestion and is more eco-friendly."

The railways are vital to our everyday lives, delivering essential goods across the country. We transported 26 billion tonne miles of freight over the last year. The railways play a big part in the economic vitality of our country and investment in them develops and grows the UK's economy.

Financial framework

Network Rail Limited is a company limited by guarantee and is the ultimate parent company of Network Rail Infrastructure Limited. Network Rail has no external shareholders and funds all investment by raising debt through its financing vehicle or by investing profits.

Ultimately the cost of all investment will be borne either by users of the railway or by government. In the shorter term, investment is financed by borrowing from the capital markets, primarily through the issuance of bonds.

The Group benefits from the financial indemnity mechanism provided by the Secretary of State for Transport. This means that in the event of non-payment of financial cash flows by Network Rail, the United Kingdom Government would meet these obligations. The chance of that indemnity ever being called upon should remain remote given the stable capital structure and regulatory regime in which Network Rail operates.

How much did the Group need to borrow this year?

The Group needs to borrow principally to fund part of its £4bn investment programme in the year.

	£bn
Cash generated from operations	2.5
Capital grants	0.2
Borrowing to fund investment (see above)	1.3
Total investment	**4.0**

During the year ended 31 March 2011 Network Rail raised £1.8bn of bonds under the Debt Issuance Programme.

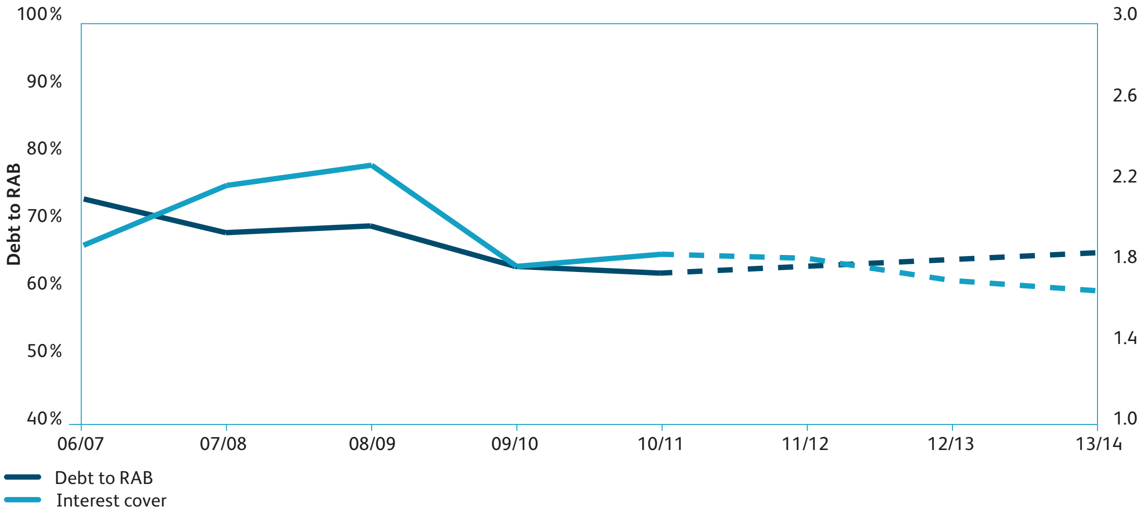
	£bn
Borrowing to fund investment (see above)	1.3
Borrowing to refinance	0.5
Bonds issued in the year	**1.8**

These bonds comprised £750m of fixed rate sterling bonds and $1.6bn of US dollar bonds. Part of this new debt was used to pay back existing loans, whilst the remainder was used to invest in the railway infrastructure. As a result, net debt rose from £23.8bn to £25.1bn.

Can Network Rail afford this level of debt?

During CP4, provided we meet our financial targets, the business will generate enough funds from its operations to cover the interest expense. The value of debt to discounted future cash flows is at comparable levels to other regulated utilities.

Financial indicators



Gearing: debt to regulatory asset base (RAB)

The debt to RAB ratio measures the value of Network Rail's debt against the value of the RAB. This establishes whether the Group debt is at sustainable levels. The RAB is a regulatory funding mechanism that acts as a proxy for future discounted cash flows generated from the railway network.

The debt to RAB ratio for the year was 63.4 per cent (2010: 63.9 per cent). At this level the business has a buffer to absorb rising costs.

The ORR places regulatory limits on this gearing ratio. The gearing ratio is well within the licence condition target of 70 per cent. Both the gearing ratio and the licence condition target are set to rise over the next three years as Network Rail invests heavily in enhancing the rail infrastructure. By 2013/14 we expect this ratio to have risen to 66 per cent against the licence condition target of 75 per cent.

Affordability: interest cover

The adjusted interest cover ratio (AICR) measures the Group's ability to pay interest on its debt after taking into account all running costs including steady state renewals. Network Rail's AICR for the year was 1.93 (2010: 1.80), which is better than both the business plan and the ORR determination.

This demonstrates that the current level of interest payable is affordable as business generated operational revenue is 93 per cent greater than the cash required to pay net financing costs.

High output track laying machine

Retirement benefits

The Group's share of the pension deficit fell in the year, from £985m to £485m through better performance of pension fund assets and changes to inflation assumptions. However the discounted obligations of the scheme are still significantly higher in value than the scheme's assets.

The triennial funding valuation is due to be completed in the summer of 2011. The trustees will review the funding position following that report.

Summary

In the last year we have made considerable efficiencies in the way we run our business. We are now much more confident that we can meet our efficiency targets in this five-year regulatory period.

Whilst our performance was adversely affected by the severe weather, the state of the network remains good, and we are working hard to return to targeted levels of punctuality and reliability. Likewise the financial framework within which Network Rail operates remains stable and robust, even in difficult economic conditions.

There is still much work to do and we need to quicken the pace of investment delivery over the next year.

This next year may shape the future of the railway industry. Network Rail will devolve responsibility for decision-making to Route Managing Directors who will lead businesses of a size equivalent to FTSE 250 companies. This will provide a platform for new ways of working and partnerships with customers. It is a time of great change for our Company and the whole rail industry, and Network Rail is in the vanguard of this transformative process. The performance we have delivered over the past year, together with a changed approach from the Company will allow us to play our part in improving the railway for all its users and stakeholders.

It is against this background that we will meet the challenge: to focus on running a safe and reliable railway, to drive further efficiencies and to deliver the exciting improvements in the infrastructure required to meet the demands of current and future generations of rail users.

Patrick Butcher
Group Finance Director
8 June 2011

Directors' report

Details of the Group's business activities, key events and changes during the year and likely future developments are contained in the Chairman's statement, the Chief Executive's review and the Group Finance Director's review. This Report should also be read in conjunction with the Corporate governance report and the Directors' remuneration report set out later in this document. All the information detailed in those sections of the Annual Report which is required for the business review, or otherwise for this Report, is incorporated by reference in (and shall be deemed to form part of) this Report.

*"Ticket prices can be quite high and they don't always reflect the service."**

Network Rail has no say in ticket pricing, but just under half of the price goes to us to run and enhance the network. Over the past year we've cut the cost of running the railway by £400m – in the five years to 2014 we aim to have delivered efficiencies of over £5bn.

**Passenger comment, May 2011*

Business review and principal activities

Network Rail Infrastructure Limited has responsibility for the management of the national rail infrastructure. Its principal activities are the operation, maintenance, renewal and, in co-operation with train operators and funders, the development and enhancement of the national rail network and in particular:

- provision to train operators of railway track access
- management of train timetabling, train planning and signalling
- maintenance, renewal and enhancement of the infrastructure and undertaking major capital programmes.

Results

The profit before tax was £438m (2009/10: profit of £395m) and the profit after tax was £313m (2009/10: profit of £284m). Further details of the financial results can be found in the financial statements commencing on page 78.

Share capital

50,084,937 ordinary shares of 0.1p and 160,000,000 redeemable shares of £1 of the Company are held by its immediate parent company Network Rail Holdco Limited.

Key future issues

While we are increasingly confident that we will be able to deliver the required cost savings and the required outputs, there continue to be a number of significant challenges that we must manage over the remainder of CP4. In updating our business plan, we have identified the key risks that need to be managed over the next three years. These are summarised overleaf.

Key financial risks

Inflation	Continued fluctuations in inflation will mean that current business assumptions are affected, leading to variations in our forecasts. This will impact both costs and income, although these will not necessarily offset each other. Potential variations include, for example, the level of actual pay awards compared to our planning assumptions.
Economic climate	Continued volatility in the economy will have an impact on our freight and property revenue.
Transformation programme	Our transformation programme is already delivering significant benefits and cost reductions. Our targets to achieve future benefits are challenging and, whilst we still expect to achieve them, there may be a risk that the actual benefits delivered are lower than assumed in our plan.
Pension valuation	The next pension valuation will be received in Summer 2011. There is a risk that there will be an increased deficit and this would require us to provide additional funding.
Investment programme	We have already reflected changes to the renewals and enhancements programme in our latest business plan. There is a risk that further variations (either through internal or external causes) could lead to non-delivery of planned efficiency savings, sustainable activity volumes or key enhancement milestones. This includes, for example, the work relating to the 2012 Olympic Games.

These risks fall within the Finance section of the Group's principal risks detailed on pages 20 to 21 and are managed as part of the risk management process.

Against the backdrop of these risks the key deliverables identified for 2011/12 are summarised below:

Deliverable description

Safety culture	Delivery of the trajectory for improvements in safety maturity as agreed with the ORR.
Customer and passenger/user focus	Improvement in train operator and passenger/user satisfaction and the process for engagement to deliver improved satisfaction and revenue growth, including implementation of further improvement in train planning systems.
Devolution within Network Rail	Development of detailed plans for increased local devolution of accountability within Network Rail and early implementation in two key routes.
Partnerships with customers	Development of new working arrangements for the next round of franchises and detailed plans for working in collaboration with existing operators not due for refranchising in the short-term.
Supplier engagement	Identification and development of projects for early engagement and collaboration with suppliers.
Asset management maturity	Delivery of trajectory for improvements in process maturity model as agreed with the ORR.
CP4 efficiency programme	Delivery of key milestones for the transformation programme and other key efficiency initiatives, in particular delivery of the benefits of the maintenance reorganisation.
Longer term efficiency	Engagement with the rest of the industry on cross industry-efficiency opportunities, including development of operating strategy and benchmarking to inform our efficiency assumptions.
Investment delivery	Delivery of key investment milestones in our delivery plan, particularly delivering the provision of infrastructure to enable 12-car operation from Bedford to Brighton by December 2011 with the overall completion of the infrastructure work to support the Key Output 1 timetable by Summer 2012.
CP5 plans	Publication of Initial Industry plan in collaboration with the rest of the industry and progress key inputs for the Strategic Business Plan.

Building on aspects of these deliverables, some of the main elements of the challenges involved are summarised below:

Safety

The Passenger Safety Indicator is currently well ahead of target and we are on course to meet our CP4 target. The Fatalities and Weighted Injuries measure, which measures workforce safety, is currently behind target, although it is now improving.

Issues relating to RIDDOR reporting highlighted last year acted as a reminder of the importance of a constant focus on safety and the importance of the safety culture of an organisation. Since last year, we have been working with the ORR to develop a joint understanding of the improvements we need to make to achieve excellence in safety management. We are developing a safety leadership and culture change programme, which will be led by a cross-industry team. Our aim is to develop an environment of zero harm, developing a safety culture through focusing on the psychological, behavioural and situational aspects of safety.

Economic environment

It is clear that the contribution rail makes to the economy was fundamental to the Coalition Government's continued support for investment during the Comprehensive Spending Review in the autumn of 2010 and why the Scottish Executive restated its commitment to investing in Scotland's railway. This support reflects the genuine successes of the last decade, successes of which the industry can be proud.

At the same time, however, there is a recognition that costs across the industry as a whole are at an unsustainable level. In addition to the 27 per cent cost reduction achieved between 2004 and 2009, Network Rail has already committed to reducing its annual costs by 23 per cent, or £800m each year, by 2014 to achieve £4bn savings. Yet there is more to do. Sir Roy McNulty's findings from his value for money study highlight the potential for the rail industry to deliver significant efficiency savings over and above those savings to which Network Rail has already committed.

It is clear that, in return for continued support for investment from the Government and other funders, the rail industry must commit itself to the reforms necessary and be willing to change in order to deliver a railway that costs a lot less. Network Rail is committed to reform and is working with customers, contractors and suppliers to do this, as well as continuing its rigorous pursuit of efficiencies. Further details of this are covered in the Chief Executive's statement and the Group Finance Director's review.

Industry working relationships

Network Rail is determined to improve the interface with its customers so that together the industry can offer better services at a lower cost. As a precursor to this, Network Rail has commenced devolving decision-making and accountability away from its centre, bringing this as close to passenger and freight customers as possible. It is also creating even greater transparency of costs to help benchmark and drive efficiencies. This transparency should bring much greater clarity to what each part of the railway costs to operate, maintain and renew. We will work to develop much deeper levels of partnership between all parties, supported by organisations and people working together and sharing the benefits of success and the risks of failure.

Train performance

A difficult autumn and early winter in 2010/11 means that Network Rail did not achieve many of the 2010/11 top level regulatory output targets for delay minutes, cancellations and significant lateness. Whilst we cannot control the weather, Network Rail needs to continue to focus on achieving resilience in the network in order to absorb the impact of extreme climatic conditions through the seasons. We are working on a wide range of initiatives to address these issues together with reducing or minimising the impact of other forms of interruption.

In the tables below key performance targets are set out. Further details can be found in Control Period 4 Delivery Plan Update 2011 at www.networkrail.co.uk

Control Period 4 outputs

Passenger train punctuality (per cent)	2010/11 Target	2010/11 Actual	2009/10 Target	2009/10 Actual
England and Wales	91.5	90.9	91.0	91.6
Long distance	89.8	87.7	88.6	88.7
London and South East	92.0	91.1	91.5	91.5
Regional	91.0	91.5	90.5	92.5
Scotland	91.3	90.1	90.9	90.6

Cancellations and significant lateness (per cent)	2010/11 Target	2010/11 Actual	2009/10 Target	2009/10 Actual
Long distance	4.5	5.00	4.9	4.6
London and South East	2.2	2.61	2.3	2.5
Regional	2.5	2.44	2.6	2.1
Scotland	1.9	2.65	2.0	2.4

Note: Scotland figures are not regulatory targets.

Passenger train services ('000s delay minutes)	2010/11 Target	2010/11 Actual	2009/10 Target	2009/10 Actual
England and Wales	5,790	6,859	6,270	6,152
Scotland	410	541	436	548

Freight services (delay mins per 100 train km)	2010/11 Target	2010/11 Actual	2009/10 Target	2009/10 Actual
Great Britain	3.41	4.29	3.68	4.02

Transformation programme

The transformation programme underpins delivery of the efficiency savings that we need to achieve during CP4 as well as delivering improvements to support delivery of the key investment milestones in our plan.

The success of the next stage of transformation, as well as the opportunity to exit the current control period at a higher performance trajectory than is reflected at present in the 2011 delivery plan update, will crucially depend on a shift to a more collaborative and devolved structure within Network Rail and the rail industry.

Control Period 5 preparation

In parallel, we are also developing plans for the next control period and beyond. Together with the Association of Train Operating Companies and the Rail Freight Operators' Association, Network Rail published a long-term planning framework in August last year, outlining our aspirations for the longer term. We are now working together to develop an initial plan to inform the Governments' high level output specifications for the period from 2014 to 2019. This plan will be published in September 2011. While developing proposals for the future, it is essential we remain focused on delivering the committed outputs and cost savings in CP4.

In summary, in the short-term we must address the challenge of value for money whilst in the longer term we aspire to deliver:

- passenger satisfaction levels of at least 90 per cent
- capacity to accommodate approximately twice as many passengers as today, with reduced journey times, as well as better connectivity between services and between modes
- improvements in the product offer for freight customers resulting in higher user satisfaction and a significant increase in rail modal share
- levels of reliability and safety that are among the best in Europe
- a financially sustainable railway through improved efficiency and revenue generation
- a reduction in carbon dioxide emissions.

Risk management

In addition to the protection of its assets (including people, property and financial resources), Network Rail is also committed to the effective management of material non-financial and reputational risks, including those arising in connection with business conduct, the environment, and health and safety.

We have a well developed and sophisticated approach to risk management aimed at supporting the delivery of its corporate objectives through early identification and reduction or removal of the likelihood of key risks and effect of those risks before they occur. Through a comprehensive and robust risk management framework, the certainty of meeting our corporate objectives is increased by providing:

- assurance that key risks are managed
- transparency on how they are managed.

Risk management structure

Whilst the Board is ultimately responsible for risk management and periodically reviews this during the course of the year, it delegates the more detailed oversight of risk management and internal control principally to the following committees which report the findings of their reviews to the Board:

- Executive Committee – executive management across the business has the overall accountability for managing all risks relevant to the business – financial, non-financial and operational. Executive management is responsible for designing, implementing and monitoring the operation of the system of internal control and for providing assurance to the Executive Committee which regularly reviews all key risks identified by functional line management
- Safety, Health and Environment Committee – assists the Board in reviewing the integrity of the methods of discharge of the safety, health and environmental responsibilities of the Company and satisfies itself as to the adequacy and effectiveness of the safety, health and environment policies and strategies within the Company
- Audit Committee – is responsible for assisting the Board in discharging its responsibilities for the integrity of the Company's financial statements and the effectiveness of the system of internal financial control and monitoring the effectiveness, performance and objectivity of the internal and external auditors
- Treasury Committee – is responsible for monitoring the effectiveness of treasury controls and the appropriateness of proposed treasury transactions.

The Internal Audit function provides independent assurance to the Audit and Treasury Committees, Board Members and the Executive Committee on the adequacy and effectiveness of the system of internal control.

The internal controls within the business are summarised on pages 65 to 66. Further details on the responsibilities of these Committees and their discharge of these are set out on pages 63 and 70.

Business risk management

Reporting within the business is structured so that key issues are escalated through the management team, ultimately to the Board if appropriate. Key to Network Rail's risk management policy is the principle that risks are continuously identified, re-assessed and monitored. The development of risk management action plans is required and these too are to be reviewed regularly. Reporting on risk management is through established management control procedures.

The various risk and compliance functions within the Company are accountable for providing objective guidance to and challenge and oversight of the business' management of risk through systems of internal control.

The responsibility for risk identification, analysis, evaluation, mitigation, reporting and monitoring rests with line management. Guidance for managers is given in the Risk Management Policy.

Identified risks are documented in controlled risk registers showing:

- the risks that have been identified
- characteristics of the risk
- the basis for determining mitigation strategy
- what reviews and monitoring are necessary.

Key performance and financial risks are monitored and reported in a mandated format within the Executive Review Meeting Packs, which are reviewed by management at period based review meetings.

In addition, executive management teams undertake reviews of the risk register. The key outputs from this are reviewed by the Executive Committee to identify those issues where the cumulative risk, or possible reputational impacts, could be significant.

This structure is able, therefore, to provide focus on the breadth of risks involved in the business of Network Rail including key risk areas relating to the current economic climate such as funding and investment-related risks and pension-related risks. Balanced with this is the emphasis required by the Company to adopt innovation as part of its delivery plans for CP4. The Transformation Programme designed to deliver the targets for CP4 is, therefore, another key focus for scrutiny in relation to associated risks.

Principal risks managed through the framework include:

Description	Impact	Mitigation
Safety The risk of death or injury from accidents on the railway for passengers, rail workers and members of the public remains Network Rail's number one consideration in everything we do. Potential causes of such accidents include infrastructure failures; level crossing misuse; irregular working; defects in traction and rolling stock; trespass; objects on the line and vandalism.	If deemed to be within Network Rail's control, civil or criminal liabilities resulting in significant costs, including fines and penalties, and loss of licence or regulatory enforcement action could arise, together with significant damage to reputation.	Work has continued during the year to identify opportunities to improve safety performance, including the intelligent infrastructure maintenance programme; level crossing improvement plan, structured review of the effectiveness of the Health and Safety Management System and workforce safety culture and behaviour initiatives.
Performance Our ability to deliver the timetable (our promise to our customers) can be impacted by many factors, both within and outside of our control. For example, adverse weather conditions; loss of business critical resources; acts of external parties all have the potential to cause severe business interruption.	An inability to service customer requirements, with the potential for loss of licence or regulatory enforcement action, together with significant damage to reputation.	We are accountable for managing the industry's train performance improvement plans. Under the auspices of the National Task Force we work closely with the train operators via the Joint Performance Improvement Plan process to identify and mitigate risks to operational delivery. We also manage the industry's response to extreme weather and major external incidents.
External environment Network Rail operates in a highly regulated environment and is exposed to significant risk from changes in political agendas.	Failure to manage and influence our key stakeholders or the political agenda has the potential to undermine the Company's long-term objectives through the imposition of unachievable regulatory settlements; changes to our operating licence and/or Company structure.	Engagement at the highest level with the Government, Department for Transport, Transport Scotland and the Office of Rail Regulation.

Description	Impact	Mitigation
Network enhancement We are committed to delivering a number of complex, high value infrastructure enhancement projects, which we must do safely, to specification, on time and within budget.	Increased costs and regulatory enforcement action could arise, together with damage to reputation.	All projects are managed using a life cycle management process known as Governance for Railway Investment Projects (GRIP) which controls the progress of a project through detailed stage gates. A comprehensive approach to programme and risk management is deployed on all major projects which includes comprehensive programme controls using latest Oracle business systems measuring cost and schedule performance. Project risk management is deployed as part of this process and tracked each period using Active Risk Manager.
Finance* We have agreed a financial settlement for the current control period which we must use to deliver the regulatory outputs. To do this, we must identify and realise significant levels of cost efficiencies across the Company.	Failure to deliver the investment, asset management and operational activity required to meet our regulatory outputs, leading to regulatory enforcement and damage to reputation.	A robust business planning process that identifies actions required to deliver efficiencies, together with a series of monthly management reviews that monitors progress and identifies corrective action where necessary.
People We have a number of substantial organisational changes going on within the Company, throughout which we must maintain an appropriately skilled, motivated workforce by developing a working environment in which people feel committed to operate safely and to deliver high performance.	Industrial disputes leading to inability to service customer requirements. Inability to retain or recruit appropriately skilled staff.	Managing engagement with trade unions; providing clear communications with the workforce; maintaining a high status of readiness of contingency plans to manage local and national threats; actively managing key players across the business.

* See also page 16.

Corporate responsibility and sustainability

Network Rail remains committed to corporate responsibility and to the pursuit of economic, social and environmental sustainability. The Company has relevant policies, standards and guidelines in place, including a broad Sustainability Policy.

The Company continues to participate in cross-industry initiatives such as the Sustainable Rail Programme, facilitated by the Rail Safety and Standards Board.

Corporate Responsibility Report

Network Rail publishes an annual Corporate Responsibility Report to provide stakeholders with a summary of performance and activities in this area. This includes sections on:

- workplace, covering issues like safety, health and wellbeing, diversity, training and development, and employee engagement
- stations and passengers, including accessibility, passenger satisfaction, railway heritage and environmental enhancements at stations
- communities, including charitable giving, community relations and community safety
- sustainable supply chain, covering our sustainable procurement programme and associated initiatives
- the environment, including waste, carbon, and biodiversity.

The next report will be published in the summer of 2011 and will be available at www.networkrail.co.uk

As in 2010, Bureau Veritas has been engaged to provide external assurance to the stakeholders of Network Rail over the accuracy and reliability of its Corporate Responsibility Report.

Corporate Responsibility Group

Network Rail's Corporate Responsibility Group (CRG) provides strategic leadership on emerging issues in the area of sustainability and corporate responsibility. It recommends targets, policies and programmes to the Executive Committee and relevant Investment Panels.

The group is chaired by David Higgins, Chief Executive, and includes a combination of senior team members, functional representatives, area specialists and an employee representative.

In 2010/11 the group met three times. Regular items on the agenda have included diversity, sustainable procurement, utilities management and wider sustainability policy.

The remit of CRG is to provide:

- direction on the policy, strategy and objectives necessary to deliver the Company's sustainability goals across economic, social and environmental areas
- measurable targets for sustainability and the specific activities and initiatives to deliver these
- a monitoring system for the progress and success of these activities.

Corporate Responsibility Index

Network Rail's corporate responsibility performance has been independently rated against the Business in the Community (BitC) Corporate Responsibility Index for the last four years.

In the latest rating in 2010/11, the Company's performance was rated as gold (2009/10: gold). The index measures Network Rail's impact across the areas of workplace, community, marketplace and the environment. This is the first year our rating has not increased since we began taking part in the benchmarking survey in 2007.

Code of Business Ethics

Network Rail has put in place its revised Code of Business Ethics which applies to all of its activities and sets out the minimum standards which the Board of Network Rail expects from all employees and Directors in their dealings with colleagues, customers, stakeholders and third parties. Consultants, contractors and business partners are also expected to act in accordance with the principles contained within the code.

Research and development

During the year the Company charged £1m to the Income statement (2009/10: £1m) on research and development. Other costs relating to significant development work have been capitalised in property, plant and equipment.

Most of the Group's development activities are applied as capital projects within the investment programme. The remainder is charged against the Income statement.

Directors

The table below identifies Directors who have served during 2010/11 and who are also Directors of Network Rail Limited. The dates of their appointment are also detailed.

Under the provisions of the Articles of Association of Network Rail Limited all Directors, except the Special Director (if appointed – there being no Special Director at the time of publication of this report), must retire by rotation, and may stand (together with any new Director appointed since the last general meeting) for re-election or election (as applicable) by the Members of that Company at least every three years. Save as shown in the table below, there were no other changes to the Board during the year.

New Non-Executive Directors Malcolm Brinded, Bridget Rosewell and Keith Ludeman will offer themselves up for election by the Members being the first such meeting after their appointments. David Higgins (formerly a Non-Executive Director) was appointed Chief Executive during the year and as such will offer himself up for re-election.

In accordance with the UK Corporate Governance Code and notwithstanding that this new code does not formally apply to Network Rail until 2012 or that Network Rail Limited's Articles of Association do not require annual re-election, all the existing Directors will also be standing for re-election at this year's Annual General Meeting.

Details of the Executive Directors' contracts of employment (service agreements) and remuneration are contained in the Directors' remuneration report.

The biographical details of the Directors can be found on pages 28 and 29.

Serving Directors during 2010/11

Current Directors	Position	Date of first appointment
Rick Haythornthwaite[1]	Chairman	23 March 2009
Executive Directors		
David Higgins[2]	Chief Executive	1 February 2011
Patrick Butcher	Group Finance Director	20 April 2009
Robin Gisby	Director, Operations & Customer Services	1 October 2008
Peter Henderson	Director, Asset Management	3 October 2002
Simon Kirby	Director, Investment Projects	1 October 2008
Paul Plummer	Director, Planning & Development	1 October 2008
Non-Executive Directors		
Malcolm Brinded	Non-Executive Director	12 October 2010
Graham Eccles	Non-Executive Director	7 February 2010
Michael Firth	Non-Executive Director	4 December 2004
Lawrie Haynes	Non-Executive Director	26 January 2010
Janis Kong	Non-Executive Director	13 January 2010
Bridget Rosewell	Non-Executive Director	20 January 2011
Steve Russell	Non-Executive Director	19 September 2007
Past Directors who stepped down during 2010/11		
Iain Coucher	Chief Executive	Stepped down on 31 October 2010
David Bailey	Non-Executive Director	Stepped down on 30 November 2010
Yvonne Constance	Non-Executive Director	Stepped down on 21 July 2010
Christopher Green	Non-Executive Director	Stepped down on 21 July 2010

1 Appointed as a Non-Executive Director of Network Rail from 23 March 2009 to 21 July 2009 at which time he became Chairman.
2 Previously a Non-Executive Director of Network Rail from 1 April 2010 to 31 January 2011 before taking up the position of Chief Executive.

Directors' interests

At no time during the year did any Director hold a material or any other interest in any contract with the Company or any of its subsidiaries other than service agreements between Executive Directors and the Company and letters of appointment between Non-Executive Directors and the Company, save that the reimbursement of expenses and cost of secretarial services for the Chairman was made by payment of £21,000 (2010: £15,000) to a company, R H Management Limited, in which he has material interest.

Under the Companies Act 2006 (CA 2006), Directors are under an obligation to avoid situations in which their interests can or do conflict, or may possibly conflict, with those of the Company. In accordance with the Act, the Company's Articles of Association were amended to allow the Directors to authorise conflicts and potential conflicts, where appropriate. Procedures, already in place prior to the CA 2006, were reviewed to ensure that they continue to be effective in relation to the disclosure of conflicts, the consideration and, if appropriate, the authorisation of conflicts by non-conflicted Directors. The Directors have not had need to exercise their powers to authorise any conflict of interest of any Director of Network Rail during 2010/11.

"When we go on weekend trips we see the men in fluorescent jackets working on the tracks."*

Network Rail employs some 35,000 people, all dedicated to running a safe efficient railway. Around 15,000 staff work on the tracks, with much of our maintenance and enhancement work happening at night and weekends to minimise disruption.

***Passenger comment, May 2011*

Insurance

Network Rail has purchased and maintained throughout the year directors' and officers' liability insurance.

Employees and business performance

Details of the number of employees and related costs are set out in Note 6 to the financial statements on page 89.

Network Rail believes that business performance improvement is influenced significantly by the skills, behaviour and attitude of its employees. Substantial investment is being dedicated by the Company to deliver high quality, accredited training and development programmes as a primary means of stimulating cultural change and management competence. Development programmes from apprenticeship schemes through to leadership skills are used.

Effective communication in raising the level of employee engagement is also important. To do this a wide range of communications media is being used, encompassing local information cascades and briefings, videos, the Company's internal magazine, email news bulletins, electronic data links and briefings by the Directors to reach all employees.

During the annual Business Briefings conducted in May and June 2011 over 7,000 employees were able to attend the geographically spread briefings at which the Company's safety and operational performance was discussed. Employees had the opportunity to question the Executive Directors on any aspect of the business that they chose to raise.

Employees also have the opportunity to voice their opinions and ask questions through Network Rail's intranet site. Face-to-face briefings and team meetings are actively encouraged and are held in all functions across the Company.

There is a direct link between business performance and engaged employees – who are safer, less likely to leave and more likely to enjoy what they do. To monitor progress in developing employee engagement, Network Rail conducts an annual independently-run survey of its employees specifically on this topic. Each question in the survey is designed by Gallup and is proven to be an accurate measure of the level of employee engagement in an organisation. Every team in the Company is expected to set their own action plan to improve their performance and their next set of scores. This survey is conducted each year, the most recent being in November 2010.

Significant progress has been made with improving the levels of engagement within Network Rail since 2002 when the first of these surveys was conducted. In that time engagement index levels have risen from 3.16 to 3.85 in 2010. Our target is 4.15. The speed of improvement in engagement continues to follow the trend in 2009 with it slowing. Plans continue to target key areas of the business where the levels of engagement do not meet the upper quartile of performance measured elsewhere in Network Rail. The next survey is scheduled to be conducted in November 2011 with a review to be undertaken in 2012 on further surveys in subsequent years.

In 2009, Network Rail also launched its Promise and its Management Principles. The Promise is Network Rail's statement of intent so all employees can work together towards a common purpose. The Management Principles are the ways by which this is to be achieved. During 2010/11 further steps have been taken to embed the Promise and Management Principles into employees' work practices and now they form part of the employee performance review process.

The Board strongly believes in the importance of consultation on issues affecting the workforce. Frequent consultation and information sharing is conducted, therefore, at regular intervals through both national and local procedures with representatives from Network Rail and trades unions.

Employee practice

Network Rail is committed to offering all of its employees a fulfilling and challenging career in an environment free from discrimination, harassment, victimisation and bullying irrespective of their gender, sexual orientation, marital status, race, nationality, ethic origin, disability, age, religion or union membership status. Its policies and procedures in recruitment and selection, training, career development, working arrangements, promotion and performance appraisal support this commitment. Moreover Network Rail continues to work with trades unions in the area of equality of opportunity and development of policy to promote best practice within the business.

The equal opportunities policy is communicated to employees. The Code of Business Ethics also highlights the importance of equality and diversity issues.

Employee review processes are in place to allow every individual manager to discuss key performance issues in a structured, fair and consistent way and to identify training and development needs. Emphasis is placed on performance against the Company's corporate values and personal development opportunities.

Charitable giving

During the year the Company donated £635,181 to charitable organisations (2009/10: £762,893) and leveraged a further £584,613 through gifts in kind, employee fundraising and other initiatives, totalling £1,219,794.

In 2010/11, the Company launched a two year charity of choice partnership with Cancer Research UK (CRUK). This year Network Rail and its employees leveraged a contribution of £884,613 for CRUK through employee fundraising, payroll giving, gifts in kind, volunteering time, and corporate donations. This is already close to meeting the two year partnership target of £1m.

The Company continued to develop its approach to regional charity partnerships, reducing them in number to 14 (2009/10: 30) seeking more strategic, long-term outcomes for both the Company and the charity.

Employees are encouraged to participate in Company-wide charitable giving schemes including volunteer leave, matched giving, and payroll giving. Network Rail offers employees up to five days paid volunteer leave per year with any charity we support. In 2010/11, 193 employees chose to volunteer (2009/10: 86). The number of volunteer days taken by these employees totalled 496 (2009/10: 233). It is believed that more volunteer activity took place but was not officially recorded, so capturing robust data will be an area of focus for the coming year.

During 2010/11, the Company matched employee fundraising contributions to the total of £150,000 (2009/10: £100,000). This £150,000 was donated to CRUK.

As of 31 March 2011, 3.71 per cent of the Network Rail workforce was signed up to the Company's Payroll Giving scheme (31 March 2010: 1.68 per cent) donating a combined total of £22,340 per month direct to charity out of their pay.

Full details of charitable giving can be found in the Company's Corporate Responsibility Report which will be available at: www.networkrail.co.uk in the summer of 2011.

Community safety

Network Rail continues to engage with rail and level crossing users and local communities regarding safety, railway crime and misuse. Regional Community Safety Managers develop and implement Network Rail's community safety strategy and are responsible for the delivery of Network Rail's award winning No Messin'! and Don't Run the Risk campaigns. The team works in communities nationwide, primarily engaging in 'hotspot' areas which represent the greatest risk to railway users and to the infrastructure.

In 2010/11 Network Rail changed the methods used to collect community safety information. As a result this year there is no comparable data available. Establishing new data sets is a focus for 2011/12.

The No Messin'! campaign has continued to target the highest offending age group of 9 to 17 year olds throughout the 100 worst offending locations for rail crime. Interventions have included a Streetgames sports project in Bristol and South Wales, an Active Schools extra-curricular programme in South Lanarkshire, and a DJ music project in the southwest of England.

In terms of level crossings, 95 safety days were held with the British Transport Police (BTP), local train operators, the Highways Agency and other key stakeholders to educate users about the consequences of level crossing misuse.

Other level crossing safety initiatives have included a partnership to include information relating to over 7,000 level crossings on satellite navigation devices, and a partnership with Royal Mail, who employs over 170,000 staff, to educate them on how to use level crossings safely. Network Rail has also funded a state-of-the-art vehicle equipped with CCTV and number plate recognition technology to tackle motorists who misuse level crossings. It is operated by the BTP and is currently being trialled in Wessex, Sussex and Kent.

In addition, 227 level crossings have been closed since Network Rail's £10m national level crossing closure programme commenced in 2010 and at the end of 2010/2011 there were agreements in place to close over 200 more.

In 2010, Network Rail announced a groundbreaking five-year partnership with the Samaritans with the aim of reducing incidents of suicide on the railway by 20 per cent by 2015. Sadly, suicides continue to occur across the network with 201 incidents in the past year (2009/10: 236). Work in partnership with the Samaritans this year has focused on:

- communication; with a targeted awareness campaign including posters and awareness materials in over 100 priority locations, distribution of 3,600 Samaritans contact cards and over 7,500 British Transport Police witness cards. In the first year of the partnership there have been over 100 million opportunities to see the campaign.
- training; with over 900 frontline railway industry staff receiving training in a one day Managing Suicidal Contact course. The course provides employees with the tools to manage potential suicide incidents.
- outreach; with The Emotional Support Outside Branch programme established on 1 January 2011. This service allows frontline staff to alert Samaritans advisors to a location where an individual could benefit from their support.

Full details on community safety, railway crime and misuse can be found in the Company's Corporate Responsibility Report which will be available at: www.networkrail.co.uk in the summer of 2011.

Political donations

In line with the Company's policy, no donations to political parties were made in the year.

The CA 2006 requires companies to obtain shareholders' authority for donations to registered political parties and other political organisations totalling more than £5,000 in any 12 month period, and for any political expenditure, subject to limited exceptions. The terms donation and expenditure are capable of having wide meanings and could extend to bodies concerned with policy review, law reform and the representation of the business community. It could also include special interest groups, such as those involved with the environment, which the Company and its subsidiaries might wish to support, even though these activities are not designed to support or influence support for a particular party.

The provision could extend to routine activities undertaken by Network Rail as part of its normal day-to-day contacts, such as its active and important policy of providing regular briefings for MPs.

Network Rail needs to work closely with all types of community representatives. As part of this, the Company has a significant amount of contact with a wide range of elected representatives (Members of Parliament, Members of the Scottish Parliament, London Assembly, Welsh Assembly and others) as well as non-governmental organisations, pressure groups and campaigning organisations. This includes meetings to discuss issues facing the Company and those using the railways, both passengers and freight traffic nationally and regionally. Opportunity is also taken each year to explain to elected representatives our business plans, the Company's performance and significant developments within the business. This is sometimes best achieved through the Company organising briefings and similar functions at which presentations are given.

Whilst it remains Network Rail's policy not to make political donations to any political parties, given the uncertainty of the precise meaning of the legislation, it considers it prudent to obtain approval from Members of Network Rail Limited to avoid inadvertently breaching the CA 2006.

Accordingly, since it remains vital that Network Rail communicates frequently with the full spectrum of political organisations, the Board annually seeks Members' approval at the AGM of Network Rail Limited for Network Rail Infrastructure Limited, as the principal subsidiary company running the railway infrastructure, to incur 'political expenditure' and to make 'political donations' to political parties or independent candidates and political organisations (as widely defined in this law).

Creditors' payment policy

It is our policy, with respect to payment of our suppliers, to settle the terms of payment when agreeing the terms of each transaction where standard terms are not used, to make suppliers aware of the terms of payment and to abide by the terms of payment.

At 31 March 2011 the Company's creditor days compared with the value of suppliers' invoices received in the year were 49 days (2009/10: 48 days).

Recognising the current economic climate and the importance of its suppliers and contractors for delivery of its business objectives, Network Rail has reviewed its payment policy. As reported in 2010, where possible, having regard to prudent business management, Network Rail continues to seek to make payments that are due more speedily than its standard terms of payment. Action has also been taken in specific cases to seek alternative methods of alleviating financial constraints on key suppliers and contractors identified on a case by case basis.

Auditors

At the next Annual General Meeting of Network Rail Limited on 21 July 2011, a resolution will be proposed to re-appoint PricewaterhouseCoopers LLP as the Group's auditors and to authorise the Directors to fix their remuneration. Details of the fees earned by PricewaterhouseCoopers LLP during the period, for both audit and non-audit work, are set out in Note 5 on page 89.

Details of the process for review of the external auditors are set out in the Corporate governance report on page 66.

Directors' responsibilities

The statement of Directors' responsibilities in relation to the financial statements is set out on page 75. The statement by the external auditors on corporate governance matters is contained in their report on pages 76 and 77.

Pursuant to the Companies Act 2006 Section 418(2), each of the Directors in office at the date of this report confirms that, so far as he or she is aware, there is no relevant audit information of which the Company's auditors are unaware and that he or she has taken all reasonable steps in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Going concern

The Directors are satisfied that the Network Rail Group has adequate resources to continue to operate for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the accounts. See Note 2 of the Accounts on pages 83 to 88 and page 75 of the Corporate governance report.

Annual General Meeting

The 2011 Annual General Meeting of Network Rail Limited will be held on 21 July 2011 in Birmingham. A separate document accompanying the Annual Report and Accounts contains the Notice convening the meeting and a description of the business to be conducted at that meeting.

Significant events subsequent to 31 March 2011

There have been no significant balance sheet events subsequent to 31 March 2011 to the date of this report.

By order of the Board

Hazel Walker
Company Secretary
8 June 2011

Board of Directors


Rick Haythornthwaite
Chairman


Graham Eccles
Non-Executive Director


Robin Gisby
Director, Operations & Customer Service


Malcolm Brinded
Non-Executive Director


Mike Firth
Non-Executive Director


Lawrie Haynes
Non-Executive Director


Patrick Butcher
Group Finance Director

Rick Haythornthwaite
Chairman
Rick Haythornthwaite, 54, has been the Company's Non-Executive Chairman since July 2009 having joined the Board in March 2009 as a Non-Executive Director. He was Chief Executive of Invensys plc, from 2001 to 2005. He was also previously Group Chief Executive of Blue Circle Industries and spent 18 years with BP in various senior roles. He is currently non-executive chairman of MasterCard Inc, a senior advisor to STAR Capital Partners and President of PetroSaudi International (UK) Ltd. His previous non-executive roles included Board membership of ICI, Land Securities and Lafarge. In the voluntary sector, he is also chairman of the Southbank Centre.

Malcolm Brinded
Non-Executive Director
Malcolm Brinded, 58, joined the Board in October 2010. He is currently Executive Director, Upstream International at Royal Dutch Shell plc. He was appointed an Executive Director of Shell in October 2004 responsible for global Exploration & Production, and from July 2009 for Upstream International. He was previously a Managing Director of Shell Transport from March 2004 and, prior to that, a Managing Director of Royal Dutch from 2002. He was also Country Chair for Shell in the UK. In 2002 he was appointed CBE for services to the UK oil and gas industry. He is a member of the Nigerian Presidential Honorary International Investor Council, Chairman of the Shell Foundation and a Trustee of the Emirates Foundation and the International Business Leaders Forum.

Patrick Butcher
Group Finance Director
Patrick Butcher, 43, joined the Board in 2009 having previously held the position of Finance Director at English Welsh and Scottish Railway (now DB Schenker) between 2004 and 2008. Before this he was Finance Director at Mapeley Ltd, London Underground and King's College Hospital. His early career was at Deloitte & Touche as a management consultant and auditor. Patrick is a Member of the Institute of Chartered Accountants (South Africa).

Graham Eccles
Non-Executive Director
Graham Eccles, 64, joined the Board in February 2010 following an extensive career in the railways. Graham's former positions include Deputy Chairman of London Midland, Chairman of the South East Strategic Health Authority, Board Member of Stagecoach Group plc, Chairman and Managing Director of South West Trains and Co-Chairman of Virgin Rail Group Ltd. He is also Chairman of Virgin Healthcare Holdings Limited.

Mike Firth
Non-Executive Director
Michael Firth, 68, joined the Board in 2004 having previously been Head of Corporate Banking at HSBC Bank plc until his retirement in September 2002. He is also a Non-Executive Director of Communisis plc and Gartmore European Investment Trust plc. He was previously a Non-Executive Director of Somerfield plc and First Technology PLC. Michael is an Associate of the Chartered Institute of Bankers and a Fellow of the ifs School of Finance.

Robin Gisby
Director, Operations & Customer Service
Robin Gisby, 54, joined the Board in 2008, having been employed by Network Rail and its predecessor since 1998 and was appointed Director, Operations and Customer Services for Network Rail in May 2004. Previous roles in the Company include two regional director positions and, prior to these, within Railtrack, Director, Network Development and Director, Freight. Before joining Railtrack he had engineering and operational roles in both the UK and overseas mainly with GKN plc. He has a first degree in Engineering Science and an MBA, and is a Chartered Engineer and a Fellow of the Chartered Institute of Transport.

Lawrie Haynes
Non-Executive Director
Lawrie Haynes, 58, joined the Board in January 2010. Lawrie is President – Nuclear at Rolls-Royce Plc. He was previously Chief Executive at White Young Green plc. Prior to that, he was Chief Executive of British Nuclear Group and a main board director of BNFL plc. He was also Chief Executive of the Highways Agency. Lawrie has a degree in Business Law (Heriot Watt) and is on the Board of Trustees of the Royal Air Force Benevolent Fund and is Chairman of its pension fund. He received an Honorary Doctorate in Engineering (Heriot Watt 2010) and is a Fellow of the Chartered Institute of Logistics and Transport.

Peter Henderson
Director, Asset Management

Janis Kong
Non-Executive Director

Bridget Rosewell
Non-Executive Director

David Higgins
Chief Executive

Paul Plummer
Director, Planning & Development

Steve Russell
Non-Executive Director & Senior Independent Director

Simon Kirby
Director, Investment Projects

Peter Henderson
Director, Asset Management

Peter Henderson, 56, has responsibility for Engineering, Asset Management, Asset Information, Maintenance and National Logistics. Joining the Board in 2002, he has over 25 years' rail experience. He began his career with the construction of the Tyne and Wear Metro, he then spent 16 years with the Hong Kong Mass Transit Railway Corporation as Head of Major Projects. He returned to the UK in 2000 to work for Bechtel where he was Projects and Engineering Director for Rail. He has an MSc in Engineering Business Management.

David Higgins
Chief Executive

David Higgins, 56, joined the Board in April 2010 as a Non-Executive Director and took up the role of Chief Executive on 1 February 2011. Previously he was the Chief Executive of the Olympic Delivery Authority (ODA) and held this role from March 2006 until January 2011. Prior to this, he was the Chief Executive Designate at the ODA from December 2005. To December 2005, he was Chief Executive of English Partnerships for three years. His early career was at Lend Lease Group, where he was appointed Managing Director and Group Chief Executive in 1995. David graduated in Civil Engineering from the University of Sydney and holds a Diploma from the Securities Institute of Australia.

Simon Kirby
Director, Investment Projects

Simon Kirby, 45, joined the Board in 2008, having been with the Company since 2003. He is responsible for delivery of all large enhancement and renewal infrastructure projects. He has held positions in the Defence industry and has been involved in a number of Land and Naval Weapons System projects including the Trident Nuclear Submarine Programme. In 2000 he was appointed Managing Director of three BAE Systems shipyards before, in 2002, becoming Managing Director of the BAE Systems Type 45 Prime Contract Organisation. Simon has an MSc in Engineering Business Management from Warwick University and is also on the board of the Major Projects Association.

Janis Kong
Non-Executive Director

Janis Kong, 60, joined the Board in January 2010. She is a Non-Executive Director of Kingfisher plc, Portmeirion Group PLC and VisitBritain, and Chairman of the Board of Trustees of Forum for the Future. During her 33-year career with BAA, Janis held a number of operational roles and, until her retirement in March 2006, was a director of BAA plc and Chairman of Heathrow Airport Ltd as well as being Chairman of Heathrow Express. Prior to that, she was Managing Director of Gatwick Airport. She was previously a Non-Executive Director of The Royal Bank of Scotland Group Plc.

Paul Plummer
Director, Planning & Development

Paul Plummer, 45, joined the Board in 2008, having been with the Company since 2002. He is responsible for network planning, the development of enhancement projects, the periodic regulatory review process, reform of the regulatory and contractual framework, and regulatory/government/european affairs. Previously he was Chief Economist and Director of Economics and Finance at the Office of Rail Regulation from 1999 to 2001. He has also worked at National Economic Research Associates (NERA), NM Rothschild and Accenture advising companies, governments and regulators on utility regulation, restructuring, privatisation, strategy, finance and M&A in the UK and overseas. He has a degree and MSc in Economics.

Bridget Rosewell
Non-Executive Director

Bridget Rosewell, 59, joined the Board in January 2011. Currently, she is Chairman and Chief Executive of Volterra, a group of companies producing economic analysis across a range of sectors. She is also Chief Economic Adviser to the Greater London Authority. Between 1988 and 2000 she was Executive Chairman of Business Strategies Ltd – subsequently sold to Experian. She was a founder of Oxford Economic Research Associates (OXERA) and previously held a position as an economics adviser to Chancellor Kenneth Clarke. Her transport experience includes preparing economic analysis for train operators, Crossrail and London & Continental Railways. She was previously a Non-Executive Director of the Department of Work and Pensions and Britannia Building Society (and was chair of the Audit Committees at both).

Steve Russell
Non-Executive Director & Senior Independent Director

Steve Russell, 66, joined the Board in 2007. Previously he was Chief Executive of Boots Group PLC between 2000 and 2003, working there since he started his first job at the Company in 1967. He was a Non-Executive Director of Barclays PLC – where he was a member of the audit committee (having previously been chairman of this committee), the risk, nomination, and governance committees. He is Chairman of Business Control Solutions and is also a trustee of St John's Ambulance and Tommy's, the baby charity. He was appointed the Senior Independent Director of Network Rail in July 2009.

Directors' remuneration report

Highlights

During 2010/ 2011 the Remuneration Committee conducted a major review of the remuneration structure for key executives and in particular the role and component parts of the Management Incentive Plan (MIP).

This review resulted in the proposal of a radically reformed incentive plan more deeply aligned to the delivery objectives for Control Period 4 ending in 2014 and leveraged with a high percentage of pay 'at risk' against the achievement of stretching targets.

It is designed to reward outstanding performance, not just in the short-term but also in the medium and longer term working from three different perspectives:

- to incentivise performance in the current year
- to support the medium-term delivery of objectives to the end of the current control period in March 2014
- to lay the foundations for sustainable, improving performance in the longer term (i.e. Control Period 5 and beyond).

The new incentive scheme was approved by Members at a General Meeting in March 2011.

Report contents

Unaudited

Governance

Compliance

The following report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002 (the Regulations) and the Financial Reporting Council's existing Combined Code. Where possible the report also seeks to accord with the new Corporate Governance Code notwithstanding that this new code does not come into effect for Network Rail until 2012.

The report also meets statutory requirements, in particular the Companies Act 2006 Schedules 5 and 8.

In addition to and in line with its objective for maximum transparency and corporate governance best practice compliance, the Committee continues to aim to reflect best practice guidelines provided by other sources including guidance published by the Institutional Voting Information Service (IVIS) of the Association of British Insurers (ABI), the National Association of Pension Funds (NAPF) and Pensions & Investors Reporting Consultants (PIRC) where appropriate.

The Committee's role

In contrast to most listed companies (if not all) the Remuneration Committee of Network Rail (the Committee) is empowered under the Articles of Association of Network Rail Limited to determine remuneration for Directors, as opposed to making recommendations to the Board. This responsibility reflects the aim of Network Rail to provide independence of the decision-making process as appropriate for the highest levels of corporate governance and reflects the importance of remuneration and incentive schemes in supporting the delivery of the Company's responsibilities.

The Committee's composition

The Committee comprises Non-Executive Directors including the Chairman of Network Rail. The following table details who have served on the Committee during 2010/11:

Current Members	From
Steve Russell (Chairman of Committee from July 2009)	September 2007
Graham Eccles	September 2010
Michael Firth	December 2004
Rick Haythornthwaite	March 2009

Previous Members	From	To
Yvonne Constance*	May 2005	July 2010
Christopher Green*	June 2005	July 2010
David Bailey*	October 2002	August 2010

* Stepped down from the Board of Network Rail during 2010.

The Group Company Secretary is the secretary to the Committee.

The Human Resources Director attends the meetings by invitation to assist the Committee in its considerations of market practice and the alignment of incentive arrangements to business strategy. The Human Resources Director is responsible for employees within Network Rail and is not a Board Director nor is he appointed by the Committee.

The Chief Executive is also invited to attend certain parts of some Committee meetings (other than when his own remuneration is being discussed or decided) to assist the Committee in its consideration of the Company's performance and key operational objectives.

The Committee's objectives

The Committee is a committee of the Board of Network Rail. Its terms of reference are available from the Group Company Secretary and can be found at www.networkrail.co.uk

In summary the Committee is responsible for determining all matters concerning incentives and remuneration of the Executive Directors of the Company. This includes:

- making decisions in respect of the framework of the Executive Directors' remuneration and its cost
- determining, on behalf of the Board, specific remuneration packages for each of the Executive Directors
- deciding the remuneration package for the Chairman without the Chairman being present
- deciding upon the form and content of the Executive Directors' MIP for each financial year (within the terms of the Incentive Policy)
- determining the framework of certain senior executive employees' remuneration as well as the form and content of their MIP.

Remuneration policy and principles

The Committee's policy in relation to executive remuneration is to reward only outstanding performance, both organisational and individual recognising that the incentive arrangements are a key part of achieving this and, as a result, these form a significant element of the compensation package for senior executives.

In order for Network Rail to achieve its responsibility for serving and collaborating with its customers – the train and freight operating companies – in the joint pursuit of the best possible current experience for the public and freight users; future prospects for the railway in Great Britain; and value for money in the eyes of both users and taxpayers – it must attract and retain the best people to lead its delivery. It must also recognise that it competes in an environment determined by competitors (broadly defined), governments and regulators.

The Committee believes that senior executives should be rewarded (on a market competitive basis) for the delivery of stretching targets beyond those targets set by the ORR. To achieve this alignment Network Rail's remuneration approach is leveraged, with a high percentage of pay 'at risk' against the achievement of those stretching targets.

During 2009/10 the Committee identified the key remuneration principles by which it must conduct its responsibilities as being:

Principle One

Targets and goals are linked with customer and stakeholder interests: the Company's remuneration policies are designed, as far as possible, to align the interests of our senior management with those of our customers, taxpayers and other diverse stakeholders in delivery of the Company's business plans and value for money.

Principle Two

Remuneration is competitive to attract and retain necessary talent: each year the Remuneration Committee assesses the competitiveness of total remuneration levels for senior executives to enable the Company successfully to attract and retain executive talent from the private as well as public sector.

Principle Three

Remuneration is proportionately balanced between short- and long-term performance objectives: the Remuneration Committee provides a total remuneration package consisting of fixed and variable pay, recognising the long-term nature of investments in the railway industry, whereby emphasis is on variable pay to reward short-term outperformance and significantly on long-term outperformance measured against pre-established targets and objectives.

Principle Four

Remuneration is aligned to effective risk management: the remuneration structure is designed to be aligned to encourage innovation by senior executives whilst discouraging excessive risk-taking.

Principle Five

Incentive awards paid fairly reflect all relevant factors: notwithstanding achievement against incentive scheme targets, the Remuneration Committee will always assess overall business performance particularly safety (and such other relevant factors as it considers appropriate) in deciding the level of incentives to be awarded.

During 2010/11 it has tested these principles once again and concluded that they still represent the key drivers for setting remuneration in Network Rail. These formed the basis, therefore, for the framework of the 2010/11 MIP review.

The principles and objectives are then structured within a total remuneration approach, defined as the sum of basic salary, incentives and benefits. The use of variable pay through the availability of incentives to form a significant part of total remuneration is intended to ensure that each individual's reward is clearly linked to the successful delivery of Company objectives.

Regulatory requirements

Network Rail has a network licence condition requirement relating to the MIP for its Executive Directors and senior executives and how this is to be cascaded throughout the Company whereby incentive awards are available to all employees upon targets being met.

Under this condition Network Rail is required, when formulating its MIP, to have particular regard to:

- securing the safe operation and maintenance, renewal and replacement, improvement, enhancement and development of the network especially operational performance, asset serviceability and condition, efficiency and economy
- infringement by Network Rail of any access contracts and safety factors
- achievement of the licence requirement of dealing with dependent persons with due efficiency and economy and in a timely manner and compliance with Network Rail's Code of Practice for dealings with dependent persons
- the extent to which Network Rail is subject to orders and to statements by the ORR on non-compliance with the licence.

These objectives are supported by a remuneration policy which can be modified only with the consent of the ORR. Under this policy the objectives and principles are to:

- provide strong incentives to deliver the actions and objectives specified in the business plan
- identify specific accountability for the achievement of the actions and objectives laid out in the business plan
- enable Network Rail to recruit, retain and motivate individuals with the right skills, knowledge, experience and competencies
- draw on best practice for listed companies in the UK where appropriate given the unique mission and structure of Network Rail
- recognise that Network Rail is accountable for the public interest as a monopoly owner and operator of an asset of considerable public importance
- recognise that Network Rail Limited is a company limited by guarantee founded on a 'not-for-dividend' principle
- reflect the fact that the Company is unable to offer the traditional benefits of UK listed companies including stock options and other profit-share mechanisms.

The ORR may also specify other objectives in connection with the MIP. In respect of the new MIP 2011/12 the ORR has exercised this right and the additional objectives are summarised on page 41.

Remuneration governance processes

Governance best practice	The Committee is committed to meeting so far as possible the principles contained within guidelines published by leading bodies in this field such as the ABI and NAPF.
Stakeholder focus	The incentive opportunities available to the Executive Directors and other senior executives are directly aligned to achievement of the performance delivery levels expected by stakeholder.
Stakeholder engagement	Being mindful of the wide range of stakeholders affected by the performance of Network Rail, the Company continues to seek transparency in relation to remuneration through the following means: • discussion with Members on the Committee's thinking on remuneration, and in particular the principles adopted by the Committee in the design of the MIP and the proposals for the terms of the MIP, which the Committee takes into consideration when determining the final terms of the MIP • publication of a statement detailing the contents of the MIP • publication of detailed reasoning for any awards made under the MIP including the points considered in deciding whether and to what extent it exercised its discretion in making any awards.
Stakeholder support	The latest form of the long-term element – the Gain Share Plan – received approval from its Members at a General Meeting in March 2011. Notwithstanding that there is no legal or regulatory requirement for Network Rail to seek formal approval by its Members of the annual element of the MIP, Members were also asked to support the annual incentive plan (AIP) in March 2011. The ORR has been closely consulted in the development of the MIP and has published correspondence to support the direction of travel and the objectives of the Committee's plans.

Regulatory MIP statement

Network Rail's network licence also requires a statement is published each year detailing the contents of the current year's Executive Directors' MIP.

The Committee's activity in 2010/11

The Committee is required under its terms of reference to meet at least once a year and during the year 2010/11 it met 11 times. The Committee's activities during that period have been summarised in the table shown on page 34.

During the year the Committee commissioned Towers Watson Limited to provide independent expert advice on remuneration generally and management incentive schemes. Towers Watson also advised Network Rail in respect of pension-related matters included in the the remuneration policies.

Stakeholder and regulatory engagement activity

Throughout the year the Committee Chairman held regular meetings with the ORR to discuss progress with the remuneration review and the ORR's opinion of whether the emerging principles are consistent with the regulatory requirements.

In December 2010 the Chairman of the Remuneration Committee, Steve Russell, reported to Members on progress with the remuneration review and invited contribution by Members to the process of re-design of the MIP. The Committee then took views of Members into account in structuring the process and key considerations in finalising the terms of the revised MIP.

In March 2011 a formal General Meeting of Members was called by the Board at the request of the Remuneration Committee at which Members were asked to approve three resolutions on the long-term incentive scheme (Gain Share Plan), the transitional arrangements relating to the Gain Share Plan and the annual incentive scheme – see pages 39 to 44 for details.

The Remuneration Committee's meetings in 2010/11

Meeting	Agenda items
April 2010	• The provisional performance outturns in respect to the Management Incentive Plan 2009/10 and reports from the Audit and SHE Committees • A preliminary debate about the appropriate targets for the Management Incentive Plan for 2010/11 • A draft of the main narrative of the Remuneration Report section of the Annual Report and Accounts for 2010 • The status of the confirmation from the ORR on the draft MIP • The 2009 and 2010 trend in the market on salary reviews both in the private and public sectors
May 2010 (two meetings)	1st meeting: • Performance outturns in respect of the Management Incentive Plan 2009/10 and reports from the Audit and SHE Committees, discussion followed on MIP awards for 2009/10 including on a letter dated 30 April from the ORR setting out the ORR's views on Network Rail's performance in 2009/10 and information received from the Executive Directors relating to performance and the ORR • Targets for the Management Incentive Plan for 2010/11 • A draft 2009/10 MIP statement • The latest draft of the main narrative of the Remuneration Report section of the Annual Report and Accounts for 2010 2nd meeting: • Decision on Executive Directors' awards under the annual and long-term elements of MIP 2009/10 • Further consideration of the mechanism and targets for the MIP for 2010/11
June 2010 (two meetings)	1st meeting: • Continued review of the terms of the MIP 2010/11 • Decision to suspend the implementation of the MIP for 2010/11 in respect of the Executive Directors pending further review by the Remuneration Committee • Decision to proceed with implementation of the MIP for all other participants • Further discussion on proposed tapers and targets of the MIP 2nd meeting: • Terms of remuneration package for an executive team member
July 2010	• Terms of remuneration package for an executive team member
September 2010	• Terms of appointment of David Higgins as Chief Executive of Network Rail
November 2010	• The composition of the Remuneration Committee • Reports relating to the review of the Management Incentive Plan for 2010/11 • Initial options for the structure of the 2011/12 Management Incentive Plan • Terms of the service agreement for David Higgins • The key changes to the pension tax regime for high earners following the Coalition Government's emergency budget • The latest best practice guidance relating to executive remuneration
January 2011	• Details of proposed newly designed Management Incentive Plan • Further update on the key changes to the pension tax regime for high earners
February 2011	• The revised proposal for a newly designed Management Incentive Plan • The formal details relating to calling a general meeting to provide an opportunity for the Members to vote on the Management Incentive Plan • The annual review of the performance and composition of the Remuneration Committee
March 2011	• General Meeting support documents and material • The ORR's letter relating to the high-level objectives of the revised Management Incentive Plan

Application of policy and principles

Constituent parts of Directors' remuneration

Set out below is a summary of the key considerations used when setting basic salary and incentive awards. These constituent parts of remuneration packages are considered by the Committee, together with pension and other benefits, as a whole for Executive Directors. It seeks to create the right balance between each of these elements so that short-term success, delivery of the objectives of the delivery plan and long-term sustainable improvement are recognised.

Basic salary

Payment	This is a fixed cash sum payable over 13 periods during the financial year.
Review	The Committee reviews salaries annually as part of the total reward package recognising market levels and personal contribution. Current salaries are shown on page 44. The figures reflect a nil increase in basic salary in both 2009 and again in 2010.
Benchmarking	Total remuneration package levels are informed by relevant pay data although not necessarily the rail sector (European or worldwide), and in particular broadly the median range of the FTSE 100. These reference points are chosen to reflect Network Rail's equivalent to market capitalisation and / or comparable companies within regulated and non-regulated with synergies of business type and business drivers and the positioning that is appropriate to Network Rail in those different comparator groups. This data, in particular incentives, is then moderated to reflect emerging circumstances, nationally (and internationally), within the relevant industry sector, Network Rail's unique corporate environment and the performance of the Company itself. This is benchmarked as for total remuneration but with positioning and progression taking into account of individual career development and current performance. The Committee recognises the need to guard against upward ratcheting of remuneration and as such it views the data with great care and scrutiny. The following has been used previously as comparator companies for benchmarking purposes: Centrica, Scottish and Southern Energy, National Grid, Balfour Beatty, FirstGroup, Bunzl, Carillion, Serco, International Power, National Express, Capita Group, AMEC, United Utilities, Go-ahead Group, StageCoach, Severn Trent, Pennon Group, Arriva[1], British Airways[2]. 1 Purchased by Deutsche Bahn August 2010. 2 Merged with Iberia January 2011 to form IAG.
Best practice	Recognition is also made of guidelines from bodies such as IVIS and NAPF on specific issues relating to basic salaries.
Workforce comparison	Reviews of basic salaries are also compared against those for the general workforce. In 2010/11 the workforce basic salary increased on average by 5.2 per cent (2009/10: 0.8 per cent). The Executive Directors' salaries had a nil increase in 2010/11 (2009/10: nil).

Incentive arrangements

Alignment with key performance targets	The new MIP has been significantly revised to take focused account of the particular requirements of Control Period 4 with it being closely aligned to the Network Rail Delivery Plan and Network Rail's Key Performance Indicators and 'Scorecard'. It is designed to reward outstanding performance, not just in the short-term but also in the medium and longer term working from three different perspectives: • to incentivise performance in the current year • to support the medium-term delivery of objectives to the end of the current control period in March 2014 • to lay the foundations for sustainable, improving performance in the longer term (i.e. Control Period 5 and beyond). As a result the MIP consists of both annual and longer term elements. Significant rewards can only be achieved if the longer terms elements of the MIP are also satisfied.
Targets and triggers	The targets under the MIP are carefully set to provide true incentive and, secondly, are set at appropriate levels to promote challenge and stretch to performance delivery. The alignment of these within the incentive measures is closely reviewed each year by the Remuneration Committee through rigorous practices and processes both in terms of the appropriateness of the measures and also the target levels set. Targets set by the ORR are reviewed as the starting point but the Committee often imposes more stringent targets.

Pensions

Railway Pension Scheme (RPS)	This is available to all employees after a qualifying period of five years' Company service (if joined Network Rail after 31 March 2004); benefit is normally payable from age 60 to 65 and accrues at a rate of one-sixtieth of final year's pensionable pay (less 1.5x single person's basic state pension), capped at £123,600 in 2010/11 for each year of membership; contribution to the RPS at the same rate as other members of the Network Rail section. An automatic cash sum is payable on retirement in the form of a lump sum (the member may choose to convert this to pension).
Network Rail Defined Contribution Pension Scheme (NRDC)	This is available to all employees joining from April 2004, providing Company contributions of up to seven per cent of pensionable pay, capped at £123,600 in 2010/11 (referred to as 'DCPS' in prior year accounts).
Network Rail CARE Pension Scheme (CARE)	This was introduced in November 2008 as an alternative to the RPS and NRDC for all employees. It provides a pension from age 65 of one-sixtieth of capped pensionable pay in each year of membership; contributions to CARE are at the same rate as for other members of the Scheme.
Other pension benefits	Some Directors are also entitled to additional pension benefits that are provided through the NRDC.

Other benefits

Certain benefits are provided on an affordability basis

- cash car allowance
- private medical insurance
- discounted rail travel
- life assurance (in addition to cover provided under the normal Scheme Rules).

MIP 2010/11 awards

Annual incentive	As detailed in last year's Annual Report, participants under the MIP 2009/10 were eligible to receive incentives based on business performance measures and targets. The annual incentive scheme for Executive Directors for 2010/11 was suspended during the MIP review. In the light of this and the events of the year, the Executive Directors and the Remuneration Committee agreed that it would be inappropriate to reinstate a scheme, and hence no payment is to be made.
Long-term incentive	The decision relating to awards under this part of the scheme was deferred pending conclusion of the design of the 2011/12 MIP. Following finalisation of that MIP it has been determined that any payments made to individual Executive Directors under the 2007 and 2008 long-term incentive plans will be deducted from the potential individual GSP payments to Executive Directors at the end of Performance Period under the new MIP. Any award under the 2009 long-term incentive element of the existing MIP will be incorporated into the GSP.

Where targets and triggers set for the relevant year have been met, awards under the MIP may be paid. In considering awards, however, the Remuneration Committee has the ability to exercise its discretion to reduce the awards in respect of both the potential annual incentive and also the maturing L-TIP.

Process adopted for 2010/11

Following discussion with the Executive Directors in March 2011, it was agreed that no awards will be made for 2010/11 by the Committee to the Executive Directors under the annual incentive element of the existing MIP.

Notwithstanding this, following the end of the financial year the Remuneration Committee has considered annual incentive awards for the other executive participants within the MIP 2010/11 and also the L-TIP awards. The following section details the process adopted by the Committee in its consideration and the outcome of this.

In preparing for its decision making in relation to potential awards for 2010/11, the Committee gathered a wide range of data, information and informed opinion was identified as a crucial tool in achieving the balanced decision needed.

Reports from the Board Committees responsible for reviewing key risk aspects of Network Rail's business – the Safety, Health & Environment Committee and the Audit Committee – were prepared by those committees at the request of the Remuneration Committee with the objective of providing detailed conclusion and observation on the key risk performance statistics and, importantly, the overall progress with the appetite and responsiveness of the executive team to risk and the effectiveness of its management of these.

The Committee also benefited from being able to consider the views of the ORR as expressed at a range of meetings over recent months between the respective Boards of Network Rail and the ORR, meetings between the Chairman of the Remuneration Committee and the Chief Executive of the ORR and between the Chairpersons of Network Rail and the ORR boards.

This formed a major contributor to the Committee's thinking given the role of the ORR and the benefit it has in expertise and resource to analyse Network Rail's performance generally and especially against the challenges of CP4.

In their non-executive capacities Committee members also made their own observations and assessment of performance of Network Rail's executives over the year. The Committee members drew, therefore, on their own views on performance and opinions voiced to them.

In May 2010 the Committee then met to consider the potential awards payable which matured for 2010/11. With the benefit of the weight, depth and breadth of all the data and opinion to hand, the Committee debated at length the overall performance of the Company, the degree of success in implementing performance improvements, the areas where progress has been less than expected or required and the implications of both in delivering the outputs for CP4 and facilitating the success of the rail industry in CP5.

Key considerations for 2010/11

The mechanism of the MIP automatically reduced potential incentive awards during the year through failure by the business to meet some of the targets set.

Annual awards 2010/11

In this report the Committee wishes to highlight its assessment on the following key focus areas of performance in relation to awards to executives below Executive Directors (who received no annual awards):

Safety

Safety remains one of the key discretionary items for assessment for the Committee, when it comes to consideration of payments under the incentive plan. Rightly so, it commanded particular scrutiny again this year. The Committee reviewed safety performance during the year against a range of safety indicators under various headings. Principal amongst these for 2010/11 were passenger fatalities, workforce fatalities, accident frequency rate (AFR) and RIDDOR incidents.

In relation to RIDDORs the emergence of issues that came to light during the year concerning reporting of incidents was a significant event. Not only did this lead to urgent review of internal processes but also the instigation by the Board of an independent inquiry led by RSSB which concluded that there were several causes of under-reporting. The Committee noted, however, that the report concluded, notwithstanding this, there was no link between this under-reporting and executive incentive schemes.

The Committee then noted that the Board had recognised that the RSSB report reinforced the extent of the challenges that the Company still faces in safety management as well as contractor and supplier relationships. This has supported David Higgins' drive to enhance the safety culture for our own workforce and that of our contractors and suppliers as well as the ongoing focus needed on safety for all who use the rail infrastructure. It also noted the significance of the negative reputational impact of the RIDDOR reporting issue.

Against these the Committee identified that progress had been made in improving passenger safety. The target for the passenger safety indicator had been achieved. The workforce accident frequency rate, however, had deteriorated over the previous year. Regrettably too there had been a contractor fatality during the year.

The Committee then applied a judgement as to how effective the executive leadership team had been in enhancing appropriate safety leadership to promote and drive safety excellence through the Company and into its supply chain throughout the year. It also considered how the Committee should respond to the challenge it laid down to the Company in 2010 in relation to the collective responsibility of all those who work within or for it in respect of the safety culture needed to pervade the full spectrum of activities in the business.

The Committee concluded that, without seeking to detract from the improvements made during the year, there was still more to be achieved, that continued focus on delivery of this was needed and further step changes in the development of the Company's safety culture needed to be undertaken. Noting its challenge to the Company in 2010 for significant improvement, the Committee exercised its discretion in order to reinforce the importance of this.

Customer service
The customer survey scores during 2010/11 moved down from the levels in the previous year reflecting poor train performance which was reflected in the PPT score. From an operational and reputational viewpoint, however, this survey scoring demanded, in the view of the Committee, reduction in the incentive awards given the importance of delivering high-quality service to and the development of improved relationships with our customers. The Committee determined that one per cent out of a possible 10 per cent maximum was the appropriate level of award.

Regulatory enforcement
Regulatory enforcement against the Company was also noted with the ORR imposing a fine of £3m during the year for a licence breach in respect of the Integrated Train Planning System (ITPS) project. Whilst the ORR's investigation found that Network Rail rightly identified the need to replace old and inefficient timetable systems and processes, its implementation of the new system failed to consider properly, mitigate and communicate the risks of initial problems affecting its key customers, operators and passengers. The operational and reputational impact on our customers was noted. The Committee noted that the impact of ITPS on performance is reflected in the PPT result and the impact of the fine is included within the Cost Efficiency Measure (CEM).

Investment delivery
In relation to investment delivery the Committee considered expenditure for the year being £1.2bn below budget. Whilst noting that some of this shortfall relates to additional efficiencies and delays caused by third parties, £0.8bn of the shortfall relates to slippage which will have resulted in some milestones being missed and will increase the likelihood of other milestones not being achieved. The Committee determined that five per cent out of a possible 10 per cent maximum was the appropriate level of award.

Efficiencies
Focusing then on efficiencies achieved in the year, overall 12.5 per cent efficiencies were noted according to the calculations that are used for CEM. The efficiency calculation for the Real Economic Efficiency Measure (REEM), which is the measure agreed with the ORR, is an efficiency for the control period to date of 13 per cent. The Committee noted that, unlike 2009/10, the two measures are in close alignment and that the ORR had agreed all bar one of the new policies.

General
More generally the Committee noted that there are no other major failures that have been identified by the ORR to the Company during the year although a number of issues and challenges had been identified such as timetabling capability.

Conclusion of the Committee

In addition to the judgements exercised above by it, the Committee also decided that, whilst progress in key areas had been achieved during the year, further changes to both what Network Rail does and how it does it were still of significant importance. In reviewing its overall responsibility to consider a discretionary overlay on the annual award for executives below Executive Director level, the Committee reached the conclusion that beyond those decisions reached against the mechanistic targets and judgemental measures the Committee felt that it was appropriate to apply a downward discretion of 15 per cent on the award. The major part of this applies to the issue of safety reflecting the challenge set in 2010. Moreover, for the executive management teams in the relevant businesses units where the RIDDOR issue arose or for which they had some accountability, an additional 10 per cent reduction would be applied. For those executives within business units involved in the ITPS project a five per cent reduction would be applied. The Committee also supported the view that the General Bonus scheme for the whole Company would be awarded at 47.5 per cent.

Annual awards 2010/11	Award maximum	Reduction applied
Mechanistic measures		
Public Performance	20%	100%
Cost Efficiency Index	20%	26%
Asset Stewardship Indicator	20%	0%
Passenger Satisfaction	20%	24.5%
Judgemental measures		
Customer satisfaction	10%	90%
Investment programme	10%	50%
Reduction against measures		44.1% of maximum payable
Discretionary overlay		15 – 30%*
Total annual award reduction		Range of 52.5% to 60.87% of maximum payable *

* Dependent on functional role.

Long-term incentive performance measure

Following approval at the Network Rail Limited's AGM in July 2009 of the three-year period running from 2009/10 to 2011/12, a new single measure for the long-term incentive has been introduced; this is Financial Value Added (FVA). This single measure is defined as the value added in the relevant three-year period, over and above the amount determined by the ORR for the relevant period.

The formula for FVA is the differences between the ORR's income and expenditure determinations and Network Rail's actual income and expenditure.

FVA is expressed in £m. Thus, if Network Rail outperforms the ORR determinations by £100m over the relevant three-year period, the FVA Index is expressed as +£100m.

L-TIP for three-year period 1 April 2008 to 31 March 2011

	Maximum target	Minimum target	Actual	L-TIP outturn
Public performance	90.0%	89.0%	89.2%	16.7%
The ORR cost reduction targets	(12,165)	(12,630)	(12,068)	100%
Total percentage of maximum award payable				**58.3%**

L-TIP awards 2010/11

Having reviewed the impact of the Committee's decision in relation to the annual awards and noting that for 2010/11 there was an automatic effect of this of reducing the L-TIP, it concluded that there were no additional extraneous reasons for reducing the L-TIP awards.

New management incentive plan 2011/12

In 2010 the Committee decided to suspend for Executive Directors the MIP for 2010/11 pending a review to assess its suitability for the new environment in which Network Rail operates. Following extensive review, research and debate the Committee formulated a new incentive plan to replace the existing MIP.

Members voted strongly in support of this new MIP at a General Meeting in March 2011.

Structure of the new management incentive plan

The Management Incentive Plan comprises two elements – annual incentives and long-term incentives:

Annual incentive plan

Payments made under the annual incentive plan (AIP) are only earned by delivering specified outcomes. For the 2011/12 AIP the outcomes are designed to incentivise not only the basic CP4 targets are met but also key business change enabling programmes are delivered.

To achieve these specified outcomes will require high levels of commitment, innovation and ingenuity of all participants. In addition the AIP is designed to encourage the members of Network Rail's Executive Committee to work together as a team and foster increased collaboration across the organisation to encourage the devolution of responsibility designed to incentivise not only the basic CP4 targets are met, but also key business enabling programmes are delivered.

Potential Awards under the AIP

The maximum potential award for the participants in the AIP is shown below:

Role	Maximum annual bonus award (expressed as a percentage of base salary)
Executive Director	60%
Executive Committee Member	60%

The maximum bonus that can be achieved by Executive Directors under the AIP has been reduced to 60 per cent of salary in 2011/12 (from 100 per cent of salary in previous years).

It is intended that the key elements of the AIP are cascaded to other Network Rail senior managers. Different performance criteria and levels of potential bonus will apply for different groups of senior managers and performance criteria will cascade through the organisation from the target and performance criteria set for the Executive Directors and Executive Committee Members so that other senior managers are measured against performance criteria that are appropriate and relevant to their role.

Key principles of the AIP

The Remuneration Committee has decided that the AIP should:

- include performance goals that not only encourage achievement but also overachievement of the objectives as established in Network Rail's Delivery Plan and in the longer term
- reflect the complexity of the business and the Delivery Plan (but without dissipating focus)
- use measures that are (1) easy to 'capture' and understand; (2) well established and understood by industry stakeholders, including Network Rail's customers and funders; and (3) transparent both internally and externally
- no longer include triggers or tapers in the new AIP
- encourage increased collaboration across an increasing devolved organisation
- allow for some modification in certain situations e.g. for major safety issues or incidents at the discretion of the Remuneration Committee (both upwards and downwards).

Structure of the AIP

The 2011/12 AIP has a number of specific components known as 'hurdles', 'business goals' and 'modifiers'. These are described more fully below:

Hurdles

The hurdles are two specific measures that must be achieved before any bonus is usually payable as follows:

- the Public Performance Target (PPT) which measures the percentage of trains arriving on time (both passenger and freight)
- the Asset Stewardship Indicator (ASI) which measures the quality of Network Rail's asset stewardship based on asset condition, reliability and performance across Network Rail's key asset categories.

The performance measures for these hurdles will be set in accordance with the targets that were set in the 2009 Delivery Plan which are planned to achieve the outputs as specified by the Office of Rail Regulation (the ORR) in its CP4 Final Determination.

The 2009 Delivery Plan (and subsequent updates) does not include an express reference to a PPT measure which incorporates the Public Performance Measure (PPM) target for passenger journeys (as set out in the 2009 Delivery Plan) and an equivalent target for freight journeys, with weightings which reflect the relative traffic flows of passenger and freight trains. The PPT creates therefore a single measure which combines both passenger and freight performance to produce a single performance measure.

The 2011/12 hurdle targets are as follows:

Public Performance Target (per cent annual average)

	2009/10	2010/11	2011/12	2012/13	2013/14
PPT	89.0	91.1	90.0*	90.4*	90.8*

* The PPT targets for the remaining three years of CP4 have been rebaselined to achieve the outputs as specified by the ORR in its CP4 final determination.

Asset Stewardship Indicator (at a network level)

	2009/10	2010/11	2011/12	2012/13	2013/14
Asset Stewardship Indicator	0.026	0.039	0.051	0.063	0.075

For any bonus to be paid, the ORR's annual assessment will cover public performance and asset stewardship.

Failure to achieve either of these two hurdles will normally result in no payment being awarded under the AIP, although the Remuneration Committee may exercise its discretion if the hurdles are missed for reasons beyond Network Rail's reasonable control.

Business goals

Assuming that the hurdles as outlined on page 40 are passed, the potential bonus entitlement under the AIP will be calculated by reference to the achievement against six business goals. For the purposes of the 2011/12 AIP these business goals are:

Measure	How performance will be assessed
Devolution	• Implementation of stages 1 and 2 • Audit control • Safety standards/assurance
Value for Money (VfM) outcomes	• Initial Industry Plan submission consistent with VfM study
Projects	• Launch of new business proposal April 2012
Asset Management	• Maturity assurance with devolution
Culture	• Leadership of organisational culture
People	• Performance appraisal

The potential bonus payout will be determined by performance against each of these business goals on an equal basis (i.e. 10 per cent of salary per measure). If the individual goal is met, then the maximum bonus for that goal becomes payable.

In assessing Network Rail's performance against each of these goals the Remuneration Committee will take account of the ORR's annual assessment of Network Rail's performance. It will also receive reports from the Audit and Safety, Health and Environment Committees on performance during the year – see page 43. The Internal Audit function will also provide verification of the targets achievements.

Modifiers

The Remuneration Committee will retain the structured discretion to adjust potential bonus payments (both upwards and downwards) based on the following 'modifiers':

- safety
- passenger satisfaction
- customer satisfaction
- supplier engagement.

The ORR objectives

For the purposes of this Plan, and in addition to the regulatory objectives set out on page 32, the ORR has specified three high-level objectives: (1) a delivery objective (2) an outperformance objective and (3) an accountability and transparency objective. Network Rail's performance against each of these objectives will be discussed with the ORR and the Remuneration Committee will take account of the ORR's views when reaching its remuneration decisions. See the ORR letter dated 24 March 2011 published on the ORR's website – www.rail-reg.gov.uk – for details.

The ORR objectives are described more fully below:

Delivery objective	The ORR has specified that the primary focus of Network Rail's Management Incentive Plan arrangements should be to incentivise proven long-term sustainable delivery of all Network Rail's performance and output obligations, coupled with a requirement to give full weight to the improvement trajectories agreed between Network Rail and the ORR to ensure progress on efficiency, service culture, excellence in health and safety culture / risk control and asset management excellence.
Outperformance objective	The ORR has specified that the rewards within Network Rail's Management Incentive Plan framework should be so proportioned that they strongly incentivise significant outperformance of the efficiency assumptions established at the 2008 periodic review.
Accountability and transparency objective	The ORR has stipulated that Network Rail's Remuneration Committee shall seek the views of Network Rail's principal funders and Members and do so openly and transparently: • initially on the full rationale and justification for the overall remuneration framework as set out within this plan and its potential implications for the remuneration of Network Rail's executives (in aggregate terms) • annually on the data and information used by the Remuneration Committee to make decisions under the Management Incentive Plan year by year (again in aggregate terms). In both cases the Remuneration Committee is required to have regard in its final published decisions to the views expressed. The decisions of the Remuneration Committee will need to include a full explanation of the Remuneration Committee's reasons and how it has dealt with the views expressed.

Remuneration Committee's judgement
By reference to the modifiers as set out above, and having had particular regard to the achievement of the three high-level objectives as specified by the ORR, the Remuneration Committee will decide whether to exercise its judgement to adjust the potential bonus entitlement. The normal modifier range will be +/–20 per cent but in the event of significant safety issues this may be extended to –40 per cent. Any bonus cannot exceed the maximum percentage as detailed in the 'Potential Awards under the AIP' section on page 40.

In deciding whether to exercise its judgement the Remuneration Committee will also consider longer term trends in performance. Moreover any adjustment will be made 'in the round' taking into account all relevant circumstances and will not be a formulaic calculation. The Remuneration Committee will publish the reasons for its decisions.

Long-term incentives – Gain Share Plan

The Gain Share Plan (GSP) is designed to complement the AIP by focusing on longer term sustainable performance over the remainder of Control Period 4 (April 2009 to March 2014). The plan builds on the existing and previous long-term incentive plans although the approach taken in the GSP is deliberately different in that the performance focus of the GSP is purely on Financial Value Added (FVA) with all other performance elements being measured and rewarded under the AIP.

The FVA is intended to reflect all sources of financial outperformance to the Company compared to the original assumptions as set out in the 2009 Delivery Plan (which was itself intended to deliver the ORR's final determination from the periodic review). Discussions are continuing with the ORR to finalise detailed application of the FVA.

A positive FVA means that Network Rail has been able to sustainably deliver the outputs as required by the ORR's final determination with less funding than was made available to the Company at the start of the Control Period. A positive FVA reflects, therefore, direct savings to the taxpayer. The higher the FVA, the greater the savings that have been made.

To ensure objectivity and aid transparency, at the end of Control Period 4, the ORR will provide its assessment of the Company's performance achieved by Network Rail before any GSP payments are made to Network Rail's executives.

How the GSP differs to previous long-term incentive plan

The key differences between the GSP and previous long-term incentive plans provided by Network Rail are:

1 It no longer focuses on performance over a three-year rolling period but now focuses on performance over the course of CP4. As a result, the GSP Performance Period will close at the end of the 2014 financial year.

2 The GSP will effectively share part of the FVA achieved by Network Rail (up to a cap) with Executive Directors and Executive Committee, meaning that the greater the FVA, the greater the individual rewards.

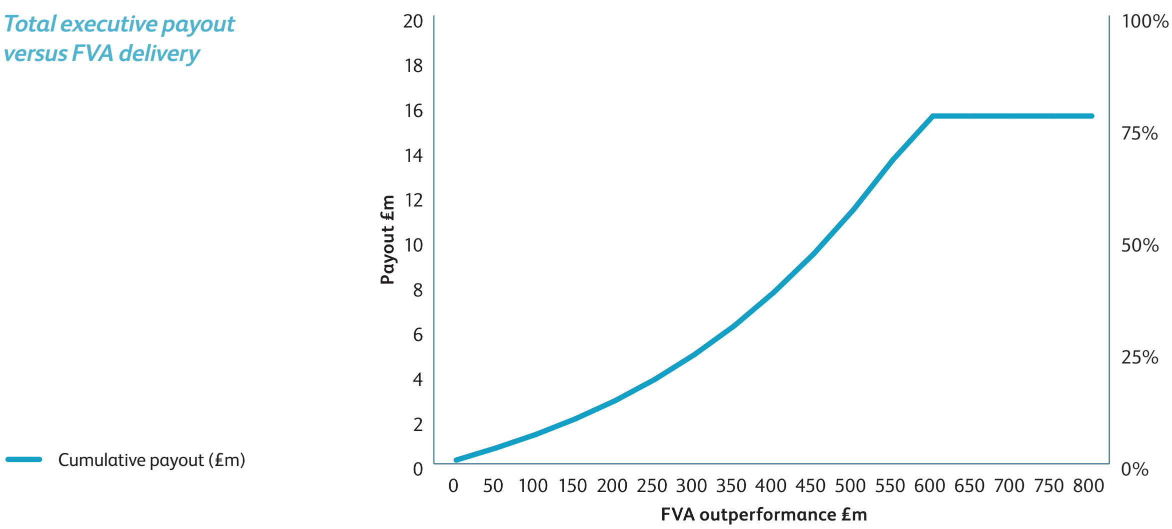
3 Whilst the design and structure of the GSP is different from the long-term incentive plan which it replaces, the potential value delivered to participants could be broadly equivalent in value had the previous long-term scheme continued into the future.

4 Subject to a six month employment eligibility period, new joiners will be eligible for payments under the GSP at the same time as other participants, backdated and pro-rated to their date of starting in that role.

Potential awards under the GSP

Executive Directors and Executive Committee will be entitled to a share of the outperformance against the regulatory determination measured by FVA. The degree of FVA achieved will directly determine the size of the potential award that is available to participants. They will be eligible to share in this outperformance on an increasing scale. FVA outperformance is capped at a maximum of £600m at which the percentage available to participants will be 2.6 per cent of FVA. This would represent a very significant achievement against the ORR's CP4 Final Determination. The link between FVA and potential bonus payments that can be earned by participants can be seen from the graph below.

Total executive payout versus FVA delivery



So, if a total of £600m FVA was achieved to the end of the control period, 2.6 per cent of that FVA would be shared between Network Rail's Executive Directors and Executive Committee.

Remuneration committee judgement (GSP)

The Remuneration Committee will also retain the discretion to adjust potential GSP payments (downwards only) based on a number of 'modifiers' reflecting the CP4 regulatory targets, such as:

- passenger safety indicator
- workforce fatalities and weighted injuries
- achievement of the PPM, CaSL and delay minutes target
- capacity including delivery of the enhancement programme
- the requirement to maintain capability at the April 2009 baseline
- network availability targets for passenger and freight services
- station condition measure
- asset serviceability and reliability measures including depot condition
- environmental sustainability measures
- excellence in health and safety culture and risk control
- excellence in asset management
- efficiency assumptions
- customer and passenger satisfaction scores.

The Remuneration Committee will assess performance against each of these modifiers 'in the round' but will individually consider whether each has been fully delivered, partially delivered or has not been delivered.

In considering the exercise of its discretion the Committee will undertake a detailed review especially in those vital areas of safety, drawing on both internal data and reports from the Audit and Safety, Health and Environment Committees in relation to the management of risk. The views of stakeholders and the ORR, and the ORR's High Level Objectives for the MIP, will be taken fully into account. The Remuneration Committee's decision will have regard to the ORR's assessment of Network Rail's performance and efficiency, including their reporting on the delivery of the regulatory requirements.

Following the review of performance against the CP4 regulatory requirements, if it is found that there is a material failure to achieve the required performance, the Remuneration Committee will exercise firmly its discretion to reduce awards: reflecting the ORR's assessment of delivery of CP4, verified material failure to meet CP4 regulatory requirements with a significant impact on users, customers or funders will normally be expected to attract reductions of real substance to awards made by the Committee. As is required by the ORR's High Level Objectives, the Remuneration Committee will seek the views of principal funders and Members, and will have regard to views expressed in reaching their decisions.

In relation to modifying against safety performance, the Committee believes safety focus within the AIP is best served through the application of its overriding discretion in such a way that sends the right signal to the executive management, and gives confidence to Members and other stakeholders that the safety improvement is truly the top priority for Network Rail. In its consideration of safety-related performance within the Company the Committee seeks to balance the prioritisation of safety with the need to encourage the delivery of business improvement. The objective is to penalise severely in the event of real, systemic Network Rail attributable safety failures, whilst exercising appropriate judgement elsewhere.

Payment of awards under the GSP

At the end of the performance period (31 March 2014), the Committee will subject any awards to an assessment that the objectives set out under CP4 have been met. It will take into account any material deviations from regulatory targets, the FVA will be calculated and corresponding payments will be made to participants subject to the maximum award size.

Payments from the pool at the end of the performance period will be made in three tranches and subject to continued employment. The first tranche will be made in July 2014 and, taken together with payments under previous long-term incentive plans, will total 50 per cent of the amount payable. The remainder will be distributed in two equal payments, one in January 2015 and one in July 2015.

Participants who leave before the end of the performance period will not be eligible for any further payments, unless they are deemed to be a good leaver. In that case, the Remuneration Committee has discretion to pro-rata any payments based on expected FVA performance to the date of leaving.

Remuneration policy in practice in 2010/11

Basic salary

Annual basic salary as at 31 March 2011

Executive Directors	£
David Higgins*	560,000
Patrick Butcher	350,000
Robin Gisby	330,000
Peter Henderson	440,000
Simon Kirby	330,000
Paul Plummer	310,000

* Appointed as an Executive Director on 1 February 2011.

Potential GSP awards

		Performance period – 1 April 2008 to 31 March 2014			
Directors	1 April 2007 to 31 March 2010 £	1 April 2008 to 31 March 2011 £	1 April 2009 to 31 March 2012 £	1 April 2010 to 31 March 2013 £	1 April 2011 to 31 March 2014 £
David Higgins*	Nil	Nil	Nil	Nil	Share of the GSP pool
Patrick Butcher**	Nil	Nil	Nil	Nil	
Robin Gisby***	121,434	61,725	Nil	Nil	
Peter Henderson	210,444	90,723	Nil	Nil	
Simon Kirby***	143,918	67,555	Nil	Nil	
Paul Plummer***	137,380	62,127	Nil	Nil	
Total	**613,176**	**282,130**	**0**	**0**	

* Appointed to the Board of Directors as Executive Director on 1 February 2011; previously a Non-Executive Director from 1 April 2010 to 31 January 2011.
** Appointed to the Board of Directors on 20 April 2009.
*** Appointed to the Board of Directors on 1 October 2008 – includes potential award amounts relating to previous position within the Company before appointment to the Board of Directors.

Notes

1 For performance period 1 April 2007 to 31 March 2010 the L-TIP value was calculated on an average of three annual award payments subject to performance conditions. These L-TIP payments will be deducted from the potential GSP payment to Executive Directors at the end of the CP4 Performance Period (April 2009 to March 2014).

2 For performance period 1 April 2008 to 31 March 2011 the L-TIP value has been calculated on an average of three annual award payments received for the years 2008/09, 2009/10 and 2010/11 subject to performance conditions. Any L-TIP payments made will be deducted from the potential GSP payment to Executive Directors at the end of the CP4 Performance Period (April 2009 to March 2014).

3 For performance period 1 April 2009 to 31 March 2012 the payments that would have been due in 2012 will be rolled-in to GSP and based on a participant's potential share of the FVA Pool as a percentage of their base salary, capped at a maximum amount of the period of the Plan. The maximum payment for the performance period 1 April 2009 to 31 March 2012 plan is equal to 100 per cent of basic salary as at 1 April 2009.

4 The 2010 long-term incentive plan was suspended for Executive Directors pending review. No long-term incentive plan payments will be made covering the three year period from 1 April 2010 to 31 March 2013 and potential awards will be incorporated into the GSP.

5 At the end of the performance period (31 March 2014), provided that the objectives set out under CP4 have been met, the FVA will be calculated and the Pool distributed subject to the maximum award size. Payments from the Pool at the end of the Performance Period will be made in three tranches and subject to continued employment. The first tranche will be made in July 2014 and, taken together with payments under previous long-term incentive plans, will total 50 per cent of the amount payable. The reminder will be distributed in two equal payments, one in January 2015 and one in July 2015. Participants who leave before the end of the performance period will not be eligible for any further payments, unless they are deemed to be a good leaver. In that case, the Remuneration Committee has discretion to pro-rata any payments based on expected FVA performance to the date of leaving.

6 These maximum sums will only be paid if the performance measures outlined on page 40 are met in full.

Pensions

Executive Directors are entitled to a pension provided from one of the three Company pension schemes on the same terms as for other employees. In addition, a pension supplement is paid either into the NRDC Scheme or as a cash alternative. Details are set out on pages 50 and 51.

Executive Directors' contractual terms

The Executive Directors of the Company are also the Executive Directors of Network Rail Limited but their employment contracts (service agreements) are with this Company. No other contractual provisions or remuneration arrangements exist in relation to their directorships of the Company or any other company within the Network Rail Group.

At the time of drawing up each service agreement the Committee takes into consideration the UK Listing Authority's corporate governance code and the recommendations published at that time by certain bodies, for example statements of the ABI and the NAPF on best practice on executive contracts and severance. These are applied as far as practicable and appropriate having regard to the nature of the business, the corporate structure of the Company and current practice of the time.

All the Executive Directors' service agreements provide for notice periods of no greater than one year, to reflect current corporate governance best practice. Executive Directors are required to give not less than six months' notice if they wish to leave.

The Chief Executive's service agreement (and the letter of appointment of the Chairman) also contains provisions for termination of his appointment without compensation upon the occurrence of certain significant financial failures of the Network Rail Group unless a majority of the Board of the Company and the DfT (in its role as provider of credit facilities) decide that these appointments should not be terminated.

Taking the principles contained within current corporate governance best practice relating to compensation in the event of early termination of a Director's service agreement, each such agreement contains an express provision requiring the departing Director to exercise their duty to mitigate their loss. Network Rail will have regard to that duty and contractual requirement on a case by case basis when assessing the appropriate level of compensation which may be payable, including using phased payments.

Current service agreements:

Executive Directors	Effective date of contract
David Higgins*	1 February 2011
Patrick Butcher	20 April 2009
Robin Gisby**	1 October 2008
Peter Henderson	3 October 2002
Simon Kirby**	1 October 2008
Paul Plummer**	1 October 2008

* Previously held the position of Non-Executive Director from 1 April 2010 to 31 January 2011.

** Previously held other senior executive position under an earlier employment contract.

Policy on Executive Directors' external appointments

It is recognised that Executive Directors may be invited to become Non-Executive Directors of other companies or hold positions in other organisations or bodies and that such appointments can broaden their knowledge and experience to the benefit of the Company. An individual Executive Director will normally be required to account to Network Rail for all fees received in respect of such directorships unless otherwise approved by the Committee.

None of the Executive Directors currently holds any such positions other than those associated with the performance of their duties within Network Rail except David Higgins who holds the following position: Government Property Unit. No fees are received by him for any such position.

None of the Executive Directors is a Non-Executive Director on the board of any listed company.

Non-Executive Directors

Non- Executive Directors' contractual terms

Non-Executive Directors are appointed by the Board on the recommendation of the Nominations Committee. Their appointment is for an initial term of three years, subject to election by the Members of Network Rail Limited at the first AGM following their appointment. They do not have employment contracts. Instead the terms of their engagement are set out in a letter of appointment and their appointments may be terminated at any time on six months' notice without compensation. Further, as mentioned above, the letter of appointment of the Chairman also contains provisions for termination of his appointment without compensation upon the occurrence of certain significant financial failures of the Network Rail Group unless a majority of the Board of the Company and the DfT (in its role as provider of credit facilities) decide that these appointments should not be terminated.

Current letters of appointment:

Current Non-Executive Directors	Effective date of original letter of appointment
Malcolm Brinded	12 October 2010
Graham Eccles	7 February 2010
Michael Firth	4 December 2004
Lawrie Haynes	26 January 2010
Rick Haythornthwaite	23 March 2009
Janis Kong	13 January 2010
Bridget Rosewell	18 January 2011
Steve Russell	19 September 2007

Note: Network Rail announced in February 2011 the appointment of Keith Ludeman as a Non-Executive Director with effect on 5 July 2011.

Non-Executive Directors' remuneration

As stated above, the Non-Executive Directors of the Company are also the Non-Executive Directors of Network Rail Limited but their letters of appointment are with this Company covering both positions.

No other contractual provisions or remuneration arrangements exist in relation to their directorships (if any) of any other company within the Network Rail Group. For the purpose of this Directors' remuneration report and the Directors' remuneration report for Network Rail Limited, therefore, the following provisions of this report also appear in the Annual Report of that company. The letters of appointment are available for inspection at the Company's registered office.

Fees are reviewed bi-annually and, with the exception of the fee for the Chairman (which is determined by the Remuneration Committee), are set by the Executive Directors to attract individuals with the appropriate range of skills and experience. In determining the level of fees their duties and responsibilities are considered, together with the level of time commitment required in preparing for and attending meetings. Benchmarking is also undertaken against comparable companies, both regulated and unregulated with synergies of business type and business drivers. The strategy for Non-Executive Directors' fees is broadly to reflect the relevant market median.

The fees were last reviewed in January 2011 and no increase in base fees or committee chair fees were awarded. Reflecting the significance of the role and best practice, a new additional fee was approved for the Senior Independent Director position with effect from 1 April 2011.

Current annual fees (audited) for the Non-Executive Directors (£)

			Committee chairmanship*				
	Board membership	Senior Independent Director	Safety Health and Environment	Remuneration	Policy and Performance	Audit	Treasury
Malcolm Brinded	50,000						
Graham Eccles	50,000						
Michael Firth	50,000					10,000	6,000
Lawrie Haynes	50,000		10,000				
Rick Haythornthwaite	250,000				Nil**		
Janis Kong	50,000						
Bridget Rosewell	50,000				10,000		
Steve Russell	50,000	9,000		10,000			

* In view of the additional responsibilities and time commitment placed upon the chairmen of Board committees, and in line with the recommendations of the Higgs Report and good corporate governance practice, additional fees have been paid to a Non-Executive Director who chairs certain of the Board committees.

** Fee introduced in 2010 but Rick Haythornthwaite, as chairman of this Committee until January 2011, waived payment of this fee.

Non-Executive Directors' contractual terms of appointment

Provision	Policy
Period of appointment	Three year term which can be extended by mutual consent
Termination without compensation	By the Director or the Company giving the other six months' written notice
Fees	As described on page 46
Expenses	Reimbursement of expenses reasonably and properly incurred in attending meetings of the Board or otherwise in the performance and discharge of their duties and responsibilities
Time commitment	Varying dependent on Board and Board committee duties but in general terms estimated to comprise as a minimum per annum*: • eight Board meetings (three of which will be off-site in 2010/11)** • typically six or more Board Committee meetings (depends on committee membership)** • three Stakeholder relationship events • two Board strategy days** • one AGM** • one Half Year Members' meeting • two Members' workshops/meetings** • three Non-Executive Directors only meetings. * Excluding induction phase. ** Each of these are anticipated to require preparation time of up to one day per meeting.
Additional directorships	Consent from the Chairman of the Board of Network Rail is required in relation to taking up other positions outside Network Rail – see below for details
Special terms	None

Non-Executive Directors – pensions

Non-Executive Directors do not receive any benefits from the Company or from the Network Rail Group nor participate in any incentive scheme or pension arrangements. Graham Eccles receives a pension from other sections of the industry-wide Railway Pensions Scheme (RPS) that is not associated with Network Rail as a result of his previous employment within the rail industry.

Policy on Non-Executive Directors' external appointments

Prior to appointment of the Board of Network Rail the existing other appointments of candidates for Non-Executive Director positions are reviewed by the Nominations Committee and assessed as to their time demands. Appointees are also required to confirm within their appointment terms that they have adequate time to meet their responsibilities as a Non-Executive Director of Network Rail. Furthermore each is required to seek approval from the Chairman of the Board before taking up any additional positions.

Directors' emoluments

The following sections headed Directors' remuneration and Executive Directors' pensions along with their associated footnotes have been subject to external audit.

The fees, which are neither performance related nor pensionable, are benchmarked and periodically reviewed against, and are in line with those paid by other comparable companies taking into account time commitment and competition for similar positions in other companies.

The total amount of Directors' emoluments for services provided solely to the Company during the year was £4m (including supplementary Company pension contributions) (2009/10: £6,155,000).

Disclosure of Directors' remuneration for 2010/11

Audited

This section of the report sets out the remuneration paid or payable to the Directors in respect of the financial year to 31 March 2011.

Directors' remuneration comparison 2010/11 against 2009/10 (£000s)

	Basic salary/fees†		Incentives+		Benefits		Pension allowance		Total		Supplementary Company pension contributions/AVC payments by the Company	
	2010/11	2009/10	2010/11	2009/10	2010/11	2009/10	2010/11	2009/10	2010/11	2009/10	2010/11	2009/10
Executive Directors												
David Higgins[A]	132	–	–	–	2	–	–	–	134	–	27	–
Patrick Butcher[B]	350	350	–	199	15	15	–	–	365	564	99	105
Robin Gisby	330	330	62	309	15	15	81	81	488	735	–	–
Peter Henderson	440	440	91	460	15	15	–	–	546	915	126	126
Simon Kirby	330	330	68	331	15	15	4	–	417	676	88	93
Paul Plummer	310	310	62	313	17	16	76	76	465	715	–	5
Non-Executive Directors												
Malcolm Brinded[C]	23	–	–	–	–	–	–	–	23	–	–	–
Graham Eccles[D]	50	7	–	–	–	–	–	–	50	7	–	–
Michael Firth	66	65	–	–	–	–	–	–	66	65	–	–
Lawrie Haynes[E]	54	9	–	–	–	–	–	–	54	9	–	–
Rick Haythornthwaite	250	188	–	–	–	–	–	–	250	188	–	–
Janis Kong	50	11	–	–	–	–	–	–	50	11	–	–
Bridget Rosewell[F]	12	–	–	–	–	–	–	–	12	–	–	–
Steve Russell	60	55	–	–	–	–	–	–	60	55	–	–
Past Executive Director												
Iain Coucher[G]*	359	613	–	641	9	15	–	–	368	1,269	214	178
Past Non-Executive Directors												
David Bailey[H]	40	56	–	–	–	–	–	–	40	56	–	–
Yvonne Constance[I]	15	50	–	–	–	–	–	–	15	50	–	–
Christopher Green[J]	15	50	–	–	–	–	–	–	15	50	–	–
Total emoluments of Directors	**2,886**	**2,864**	**283**	**2,253**	**88**	**91**	**161**	**157**	**3,418**	**5,365**	**554**	**507**

A Joined the Board of Directors as Chief Executive on 1 February 2011; previously a Non-Executive Director from 1 April 2010 to 31 January 2011.
B Joined the Company on 2 March 2009 and was appointed to the Board of Directors on 20 April 2009.
C Joined the Board of Directors on 12 October 2010.
D Joined the Board of Directors on 07 February 2010.
E Joined the Board of Directors on 26 January 2010.
F Joined the Board of Directors on 18 January 2011.
G Left the Board of Directors on 31 October 2010.
H Left the Board of Directors on 30 November 2010.
I Left the Board of Directors on 21 July 2010.
J Left the Board of Directors on 21 July 2010.

† Executive Directors receive salaries and Non-Executive Directors receive fees.
+ In March 2011 it was agreed that no annual incentive awards for 2010/11 will be made.
* See also additional details on page 49.

Notes

1. 'Benefits' – all Executive Directors received life assurance benefits during such part of the year as they were employed by the Company that relate to the cost incurred by the Company of insuring the Directors' life assurance benefits which, had they died during the year, could not have been wholly paid by the relevant pension scheme and would therefore have been met by the insurance company. The disclosure also includes the cost of private medical insurance, car benefits and any travel subsidy. All the numbers disclosed include the tax charged on the benefits. No Director received an expense allowance during the year
2. 'Pension Allowance' – these Executive Directors received supplementary Company pension contributions paid as a cash allowance that was selected as an alternative to an additional pension contribution to the NRDC Scheme.
3. For the purpose of disclosure required by Schedule 5 of the Companies Act 2006 the total aggregate emoluments of the Directors in respect of 2010/11 was £4m, this includes supplementary Company pension contributions (AVC payments by the Company) (2009/10: £6.2m).
4. The supplementary Company pension contributions/AVC payment by the Company reflect values for the full year (with the exception of A which reflects the part year commencing 1 February 2011).

Compensation for loss of office

The Remuneration Committee exercised its discretion over compensation for loss of office for Iain Coucher, taking into account his length of service, his personal performance and his overall contribution to the performance of Network Rail. On termination of his contract, he received a compensation package totalling £1,075,000.

This sum included pay in lieu of his contractual salary, untaken annual leave entitlement and benefits, and compensation for loss of office in respect of his 12 month notice period of £705,000. Pension contributions are detailed on pages 50 and 51. In addition, under the terms of his contract, Iain Coucher was entitled to participate in the incentive scheme for 2010/11. An amount representing a negotiated settlement to close out future potential L-TIP awards of £370,000 has been paid. The remainder of entitlement to incentive award for that year was made subject to the Remuneration Committee's decision on the annual award to be applied to the other Executive Directors. As the Committee has since determined a nil annual award for 2010/11, no further sum will be payable to Iain Coucher.

Executive Directors' pensions

The tables on pages 50 and 51 show the accrued pension entitlement from the respective Network Rail pension scheme for each Executive Director of the Company during the year ended 31 March 2011, together with the increases in those benefits during the year, calculated using the accrued benefit basis.

The increases in pension benefits during the year represent the amount of the extra annual pension entitlement earned resulting from additional length of service and/or changes in salary and/or additional contributions in respect of money purchase benefits.

The increase in accrued defined benefit during the year is shown in the table on page 50. Values are normally shown before (column A) and after (column B) after the exclusion of the effect of inflation. All benefit values shown exclude the effect of any additional voluntary contributions made by the Director.

Executive Directors participate in one of Network Rail's three occupational pension schemes: RPS, CARE or NRDC. Benefit accrues at a rate of one-sixtieth of capped final pensionable pay (RPS) or capped average pensionable pay (CARE) for each year of membership. NRDC provides benefits on a money purchase basis. Executive Directors contribute at the same rate as other members of the respective scheme. In addition, some Directors are entitled to either additional money purchase pension benefits that are provided through the NRDC Scheme or an additional cash allowance.

In normal circumstances the earliest age at which members are entitled to receive their defined benefit pension without actuarial reduction is age 60 in the RPS or age 65 in the CARE Scheme. However, the Directors can retire early on the same terms and conditions that apply to other members of the respective scheme from the age of 55 or in some cases age 50 in the RPS. The minimum retirement age in the RPS increased from age 50 to age 55 from 6 April 2010 for members joining after 5 April 2006 (with the exception of some members who retain the 'protected retirement age' of 50 in certain circumstances). The actuarial reduction factors that apply under the RPS are a two per cent per annum reduction between the ages of 60 and 55 and a three per cent per annum reduction for ages below 55, although for RPS members not covered by the Protection Order under the Railways Act 1993 cost neutral early retirement terms apply for pension benefits accrued from July 2009. In keeping with other members of the RPS, the right to take early retirement benefits from the RPS is at the option of the individual, subject only to having left the Company's employment (however, members may take early retirement benefits whilst still in employment with Company consent, in which case the pension is then subject to cost neutral early retirement terms).

In the CARE Scheme, Directors may retire early from age 55, the employer's consent is required and the pension is then subject to cost neutral early retirement terms.

In the NRDC Scheme, Directors can retire early from age 55 on the same terms and conditions that apply to other NRDC members, subject to Trustee consent. As NRDC benefits are provided on a money purchase basis, actuarial reduction factors are not applicable.

In addition to members' benefits, dependants' pensions are payable on the death of the member, in line with those payable to all members of the RPS and CARE Scheme. On death in service these are at the rate of half the pension the member would have received at normal retirement age. On death in retirement or after leaving service, the rate is half the member's RPS pension on death and in the CARE Scheme the rate is half the member's standard pension on death where standard pension is the pension payable before commutation. In both RPS and CARE Schemes any benefits arising from additional voluntary contributions are not included in dependants' pensions. In addition, under both schemes pensions are payable to eligible surviving children based on a proportion of the dependants' pension.

Dependants' and children's pensions are not payable automatically from the NRDC Scheme on the death of a member. However, a dependant may use all or part of the lump sum to purchase an annuity with an insurance company if the lump sum exceeds £5,000 and on retirement the member may purchase an annuity which will provide a dependants' pension on the member's death.

The RPS Rules provide for increases to all pensions in payment and deferment in line with Review Orders published under the Pensions (Increase) Act 1971. Such increases have previously been based on increases in the Retail Prices Index, however, following a change in the Government's measure of inflation from April 2011, pension increases will be calculated by reference to the Consumer Prices Index.

The CARE Scheme Rules provide for increases to pensions in payment and deferment based on the Retail Prices Index, subject to a maximum annual increase of five per cent.

In the NRDC Scheme the member has the option on retirement of purchasing an annuity which will be increased in line with the Retail Prices Index or other agreed basis.

Additional pension benefits

As described above, some Directors are entitled to additional pension benefits in which case the Director may choose either to have the gross payment made to the NRDC Scheme, or take this as a cash salary supplement subject to an adjustment for National Insurance Contributions. Future contributions are at a predetermined level, and the amount has been notified to each Director.

The contributions made during the year together, where appropriate, with contributions in respect of benefits accrued prior to the year under review are shown on page 51.

The RPS operates a matching Additional Voluntary Contribution facility, whereby voluntary pension contributions paid by Scheme members are matched by equivalent payments from the Company, up to certain limits. These matching arrangements were frozen for members of the Network Rail Section of the RPS at the levels applicable on 3 November 2003 and this limit was applied to Directors as to other Scheme members (matching is not available for new RPS members with the exception of those transferring in from other RPS sections who may retain previous matching subject to certain conditions).

Core pension benefits – audited

	Gross increase in accrued occupational pension £ (A)	Increase in accrued occupational pension net of inflation† £ (B)	Total accrued occupational pension at 31 March 2011 £ (C)	Transfer value of accrued occupational pension at 31 March 2010 £ (D)	Transfer value of accrued occupational pension at 31 March 2011 £ (E)	Total change in transfer value during period £ (F)	Value of net increase in accrual over period £ (G)
Current Directors							
David Higgins*	N/A	N/A	N/A	N/A	N/A	N/A	1,454
Patrick Butcher**	4,098	4,094	4,190	15,497	32,518	8,122	22,878
Robin Gisby**	2,060	1,215	29,320	393,537	408,999	2,196	3,682
Peter Henderson**	2,060	1,582	17,473	250,043	278,281	14,972	11,932
Simon Kirby**	2,060	1,629	15,972	129,638	134,029	(8,875)	401
Paul Plummer**	2,060	1,438	22,124	184,791	182,990	(15,068)	(1,372)
Past Director							
Iain Coucher***	3,268	2,790	18,681	171,128	186,437	7,785	20,268

† As in prior years inflation adjusted values reflect the year to 30 September. The inflation adjustment is based on the revaluation method in accordance with the Trust Deed and Rules of each pension scheme. The RPS is now subject to increases based on CPI and therefore a revaluation rate of 3.1 per cent was applied in respect of members of that Scheme. The CARE Scheme reflects revaluation based on RPI and therefore a rate of 4.6 per cent was applied in respect of that Scheme member.

* Became Chief Executive on 1 February 2011 and elected to be a member of the NRDC Pension Scheme from that date.

** These Directors were Directors for the whole year.

*** Stepped down from the Board of Directors on 31 October 2010.

Notes

1 Pension accruals shown are the amounts which would be paid annually on retirement (or earlier leaving) based on service to the end of the year.

2 Transfer values as at 31 March 2010 (D) and 31 March 2011 (E) have been calculated in accordance with 'The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008'.

3 The change in the transfer value (F) includes the effects of fluctuations in the transfer value due to factors beyond the control of the Company and Directors, such as stock market movements. It is calculated after deducting the Director's contribution.

4 The value of net increase (G) represents the incremental value to the Director of their service during the year, calculated on the assumption that service terminated at the year end. It is based on the accrued pension increase (B) after deducting the Director's contribution.

5 The NRDC Scheme member does not have an accrued pension as this only applies to defined benefit schemes and therefore only the employer pension contribution is shown (G) based on seven per cent of pensionable salary up to the notional earnings cap (£123,600 for all four weekly pay periods ending before 6 April 2011 and £129,600 for subsequent pay periods).

6 The Company operates a SMART arrangement whereby, for participating employees, the employee member's normal contributions are paid by the Company and the employee member's pensionable pay is reduced accordingly. For the purposes of these disclosures any SMART contributions have been treated as employee member contributions on a notional basis.

Additional pension benefits – audited

	Company contributions to additional pension provision or optional salary supplement whilst a Director during the year £	Company contributions to additional pension provision or optional salary supplement whilst a Director during prior year £	Matching Company additional voluntary contributions whilst a Director during the year £
David Higgins[A]	26,763	–	–
Patrick Butcher[B]	99,200	105,264	–
Robin Gisby[B,C]	81,200	81,251	–
Peter Henderson[B]	126,304	126,305	–
Simon Kirby[B,E]	92,487	93,178	–
Paul Plummer[B,C]	75,951	75,999	4,844
Iain Coucher[D]	213,719	178,405	–

A This Director was appointed as an Executive Director on 1 February 2011 (previously held a Non-Executive Director position).
B These Directors were Directors for the whole year.
C These Directors elected to receive an equivalent additional allowance in 2010/11 in lieu of additional pension contributions. This payment is included in the benefit figure reported on page 48.
D This Director stepped down on 31 October 2010.
E This Director elected to switch from additional pension contributions to an equivalent annual allowance with effect from 13 March 2011.

Notes
1 None of the Non-Executive Directors are members of any Network Rail pension arrangement nor do they have other pension entitlements save that Graham Eccles receives a pension from the Railway Pension Scheme relating to his previous employment – see page 47 for details.
2 Where a Director is entitled to additional pension contributions they can choose the payment either as a salary supplement, less an adjustment for National Insurance Contributions, or a pension contribution to the NRDC Scheme.

Performance graph

As the Company has no listed shares total shareholder return cannot be illustrated.

Directors' interests

As the Company has no listed shares Directors have no interests in shares of the Company.

On behalf of the Remuneration Committee

S.B. Russell.

Steve Russell
Chairman, Remuneration Committee
8 June 2011

Corporate governance report

2010/11 was my first full year as Chairman of Network Rail and I see this corporate governance report as my opportunity to describe the changes I have made during the year, how the Company has been managed and how the Board has performed.

Chairman's overview

What changes have taken place in 2011?

The Board appointed a new Chief Executive, David Higgins, to succeed Iain Coucher's leadership of Network Rail's executive team.

The succession process, which was led by a sub-committee of the Nominations Committee, was critical in identifying the best candidate to lead Network Rail into a challenging new era. The succession process is reported in more detail in the Nominations Committee Report on page 67.

A task that I set myself as Chairman from the outset was to reshape the non-executive element of Network Rail's Board, strengthening it in order to provide world-class corporate oversight. With the appointment of Malcolm Brinded and Bridget Rosewell during the year, the experience and capabilities of the Network Rail Board are shaping up exactly as I had hoped. As an economist, Bridget brings a blend of economic and strategic skills to the Board and Malcolm brings extensive experience of engineering projects and operations. One further addition announced earlier in 2011 has been the forthcoming appointment of Keith Ludeman who will take up his Non-Executive Director role with us in July 2011. Keith will provide passenger-focused expertise within the railway industry. These three high quality individuals join the Non-Executives appointed in 2010 – Lawrie Haynes, Janis Kong and Graham Eccles – and existing Non-Executive Directors – Mike Firth and Steve Russell – to form a highly experienced and challenging team working closely with the executive directors in the leadership of Network Rail. The work of the Nominations Committee in identifying these individuals is outlined in the Nominations Committee Report on page 67.

With a strong non-executive element in place, certain measures have been put in place to enable the Non-Executive Directors to support the Company as it embarks on a new phase of its evolution. These measures include:

- **Nominations and Corporate Governance Committee** In addition to recommending Board appointments, leading the evaluation of the Board and succession planning, the newly extended remit of the Committee includes reviewing the governance structure for fitness for purpose including the impact of governance from the boardroom to the business.
- **Lead Non-Executives for Board agenda items** To strengthen the challenge to the Executive Directors on matters presented to the Board for consideration, we have introduced, on a trial basis, the concept of appointing a lead Non-Executive for each non-regular agenda item who is available to discuss the content and presentation of the item with the lead Executive Director and has an input into the considerations that should be addressed on the particular matter.
- **Board evaluation** The effectiveness of the Board is vital to the success of Network Rail. Accordingly the Nominations and Corporate Governance Committee is charged by the Board to establish annually a process to review the performance of the Board, its principal Committees and individual Directors. The Committee requested this year that the Chairman should provide a recommended way forward after consultation with Members as a transitional step. The process has been designed to assess the Board's performance against the aspirations contained within Network Rail's Governance Principles and the guidance provided within the UK Corporate Governance Code as well as the effectiveness of the Board and its Committees, including the effectiveness of the processes by which the Board is held to account by its stakeholders. Details of the evaluation process for 2011 are set out in the Nominations Committee Report on page 67.

Throughout the year, there has been intense consideration of how the governance might be enhanced. In late 2010 the Board commenced a major review of the governance and accountability of Network Rail. This review included consultation and active engagement in dialogue with key internal and external stakeholders, including Members, in order to formulate potential governance models for Network Rail. These proposals were presented to stakeholders in April, again including to Members.

The proposals contained reforms to the corporate governance of Network Rail based on five principles:

- **Accountability** Network Rail must be demonstrably more accountable to a wider audience. This requires open scrutiny, true transparency and a change in culture so that all choices balance not only safety and engineering excellence but also consideration of how it is paid for
- **Clarity** Any new structure must be designed to be easily understood both internally and externally
- **Quality** Good corporate governance needs good people. Britain's railways deserve the best people with the right skills and experience to deal with the complex issues at stake
- **Openness** Good corporate governance and better accountability require there to be a free flow of reliable information and constructive dialogue both internally and externally
- **Operational autonomy** Better accountability must not be at the expense of letting the Company get on with its job.

Details of the proposed reforms are currently being developed in continuing consultation with Members and other stakeholders.

To enhance the transparency and quality of our governance, we have also introduced a number of new initiatives to provide greater insight to our stakeholders on the matters under consideration by the Board:

- **Governance letters** I write to Members on a quarterly basis on the Board's work over the preceding three months and on key governance topics including the recent developments in governance structure, business performance, key Board and executive team decisions to encourage increased insight and debate amongst the Members on the governance of Network Rail.
- **Disclosure of Board and Board Committees minutes and agendas** The Board has taken the decision to publish the agendas and minutes of all Board and Board Committee meetings to the Company's Members. This will provide Members with a vehicle to assure themselves on the range of business covered by the Board.
- **Trade union attendance at Safety, Health and Environment Committee meetings** We have offered the Company's trade unions the opportunity to attend the Committee's meetings on a rotating basis from 2011.

What shaped the Board's agenda in 2010/11?

In 2010/11 we have focused on leadership culture, flows of communication and quality of dialogue, scrutiny and assurance. A key focus too has been the future of the rail industry and Network Rail's role within it. We have been part of a far-reaching dialogue that has included the Coalition Government, McNulty Review, the ORR, train operators and suppliers. The Value for Money study process has been a constructive one for Network Rail and the industry. It has reinforced the need for us to deliver on our Control Period 4 plan while, at the same time, finding a way of doing business better, faster and at a lower cost if we are going to be in a position to meet the demands of Control Period 5 and resolving, in particular, the capacity and value for money issues that the nation and our customers face. Details of the challenges and ambitions are set out in the Chairman's statement, the Chief Executive's review and the Finance Director's review on earlier pages. This report is confined to the status of Network Rail's corporate governance within the context of the current shape of the rail industry and the structure of Network Rail during 2010/11. Clearly the outcomes from the McNulty Review, our programme for devolution within Network Rail and the discussions we are currently having with our customers, contractors and suppliers will influence significantly the governance shape of Network Rail going forward.

Objectives for 2011/12

The key objectives for the Board 2011/12, besides continuous improvement of our scrutiny and challenge dialogues, are the evolution of our governance framework to address three key challenges. First, to ensure that our governance is effective in the new world of devolution and partnering. Secondly, to improve the clarity of our accountability to funders and other key stakeholders. Finally, to broaden understanding of the workings of the Board and the Company through a shift in culture towards far greater openness and transparency.

Rick Haythornthwaite
Chairman
8 June 2011

Compliance with the provisions of the UK Corporate Governance Code

Network Rail considers that good corporate governance is central to achieving our objectives and to the principle of safeguarding stakeholders' interests in the rail infrastructure. We are committed to high standards of business behaviour and have put in place a robust governance framework which is focused on achieving the right behaviours not only in the boardroom but across the business. This forms the basis for effective decision-making and delivery of the quality rail infrastructure this country needs.

Under its network licence, Network Rail is required to comply with the governance principles contained in the Combined Code. The Code was amended and renamed as UK Corporate Governance Code in May 2010 and applies to financial years beginning on or after 29 June 2010. Given the timing of its financial year end, this new version of the Code does not apply formally to Network Rail until 2012. Notwithstanding this, the Board has chosen to report against this latest version of the Code on a voluntary basis.

The Directors consider that Network Rail has complied with the provisions of the Code.

Board of Directors

The Board is responsible to Members and other stakeholders for the appropriate overall management of Network Rail. In particular the Board governs the strategic direction of the business, supervises its operational management and provides leadership within a governance framework which it oversees. It is, first and foremost, collectively responsible for driving the success of the Company, providing entrepreneurial leadership within a framework of the High Level Output Specifications sought by Government and establishing prudent, effective controls which enable risk (both operational and financial) to be assessed and managed. This responsibility extends to taking overall responsibility for financial performance, internal controls and risk management of the Company. It also sets Network Rail's values and standards required to meet its obligations to its Members and other key stakeholders.

At present, the Board comprises a Non-Executive Chairman (Rick Haythornthwaite), six Executive Directors including the Chief Executive (David Higgins) and seven Non-Executive Directors (all independent). Biographical details for the Board members are given on pages 28 and 29. An additional independent Non-Executive Director, Keith Ludeman, will join the Board in July 2011. Having six executives on the Board, with specific responsibilities for key parts of the business, helps to provide the non-executives with a wider and more immediate view of operational issues and make sure that views and perception are not dominated by a single executive voice. The non-executives bring independence, external skills and perspective as well as challenge to strategy development. This independence is critical to providing assurance that the executive team is exercising good judgement in key areas of delivery strategy and to sound decision-making in areas where there are possible conflicts of interest, such as on remuneration policy, Executive Director appointments and senior executive team succession.

The Board aims to carry out its role by focusing on seven key issues:

- **the purpose of the organisation** why it exists and what it wants to be
- **its strategy** how it proposes to achieve success and manage risk
- **performance measurement** implementation and monitoring of the Company's financial and non-financial indicators, and assessing the Board's own performance and that of the executive team
- **accountability and communication** the processes of dialogue and reporting by which it informs its Members and wider stakeholders, and takes account of, and learns from, the feedback received
- **added value** generated by constructively questioning and challenging the thinking of the executive management team and ensuring that appropriate controls are in place and operate effectively
- **the Company's values** what it stands for and will not stand for
- **its key relationships** who and what it depends on for success, the delivery of its values and the development and/or protection of its corporate reputation.

Board activity

The Board has adopted a timetable of eight scheduled Board meetings each year. Facility is also made for special Board meetings should the need arise. The Board held two additional Board meetings in September 2010 and March 2011 responding to specific business needs at those times. The format for each meeting is designed to enable focus on and opportunity to debate future strategic issues facing the rail industry in addition to reviewing current performance of the business. A key strategic item of business is allocated to each meeting's agenda for particular review and discussion. Each meeting also includes reports on the safety, health and environmental performance of the Group as well as on operational and financial performance against the business plan and targets.

There is a schedule of items to be brought to the Board throughout the year which forms part of a forward agenda.

The Board generally meets at the Company's office in London but at least two meetings each year are held at different parts of the country which gives the Directors the opportunity to meet employees and community stakeholders. During 2010/11, the Board met stakeholders of Edinburgh, Manchester, Cardiff and Birmingham.

Matters reserved for the Board

Certain matters are formally reserved for decision by the Board and its duly authorised committees. These include approval of:

- the Group's overall strategy, business plan and annual operating budget
- the half-year and year-end financial statements of the Company
- material changes to the network licence
- key pension matters
- adequacy of internal control systems
- major capital investments and expenditure
- risk management strategy
- appointments to the Board
- review of the performance of the Board and its committees.

Matters delegated to the Executive Committee or below are also subject to financial and other risk limits above which Board approval is required.

Executive Committee

The Committee manages the functions of the business and implements the operational and financial objectives within limits set by the Board. The Executive Committee is chaired by the Chief Executive, and comprises all the Executive Directors and a number of senior executives.

The Committee met 12 times during 2010/11 and its principal activities included approval (within its delegated authority) and review of operational issues and activities of the Company including:

- the operational, financial and safety, health and environment performance of Network Rail
- reports into significant rail incidents
- budget for 2011/12
- investment projects and contract awards
- progress reports on significant projects and programmes
- route utilisation strategies
- performance against the top level outputs specified by our regulator
- risk management performance and reporting
- development of corporate key performance indicators
- industrial relations matters
- human resources policies and strategic plans
- the status and activities of the Transformation Programme
- regulatory matters.

In addition to the Executive Committee, there is a defined structure of other executive steering groups and panels with terms of responsibilities focusing on specified aspects of the operational needs of the business with prescribed levels of authority.

Separation of the roles of Chairman and Chief Executive

The roles of the Chairman and the Chief Executive are distinct, separate and complementary. The responsibilities of the non-executive Chairman include leading the Board and ensuring its effectiveness. Working closely with the Group Company Secretary, he sets the agenda for the meetings of the Board and arranges for a timely, accurate and clear information flow to the Board members both at Board meetings and also through updates on issues arising between meetings. Supporting papers for scheduled meetings are distributed in the week before each meeting. Access to documents is also available through the Group Company Secretary.

The Chairman's contractual commitment to the Group is two days per week although, since his appointment as Chairman in July 2009, his actual level of activity relating to Network Rail has exceeded this. The Chairman has confirmed that the performance of his outside responsibilities continue to be achieved without detriment to his duties to Network Rail and he anticipates this will remain so going forward. His main interests outside the Company are set out in his biographical details on page 28.

The Chief Executive is responsible for leading and managing the business on a day-to-day basis within the authorities delegated by the Board and is accountable to the Board for the financial and operational performance of the Group.

Statements of Responsibility for both the Chairman and Chief Executive, which have been agreed by the Board, are published on Network Rail's website and are summarised below:

Role of Chairman

General

Providing leadership of the Board.

Being the pivotal role in creating the conditions for overall Board effectiveness.

Setting the Board's agenda for approving the Company's safety, operational and financial strategies.

Promoting high standards of corporate governance and seeking compliance with the provision of the Code to the extent that it applies to the Company.

Seeking to uphold the highest standards of integrity and probity of the Board as a collective body.

Board

Chairing Board and general meetings of the Company.

Promoting effective decision-making and constructive debate within the Board with a focus on strategic matters and forward looking agendas.

Managing the process by which the Board receives information to enable the Board to promote the success of the Company.

Managing the Board agendas to allow sufficient time for discussion of key issues.

Actively encouraging Board members to contribute fully in addressing and agreeing on all major strategic issues.

Addressing the development needs of the Board as a whole.

Directors

Establishing a close and effective working relationship with the Chief Executive and other Directors.

Encouraging active engagement by each of the members of the Board and effective relationships and open communication between Directors.

Facilitating the effective contribution of Non-Executive Directors to the responsibilities of the Board.

Taking the lead in the design, implementation and monitoring effectiveness of the induction and ongoing development of the individual Directors.

Stakeholders

Promoting the provision of effective communication with Members and other stakeholders.

Maintaining sufficient contact with Members and other key stakeholders to understand their issues and concerns, in particular relating to governance and strategy.

Managing the process by which the Board has an understanding of the views of stakeholders.

Role of Chief Executive

General

Creating, maintaining and regularly reviewing the organisational structure for the business of the Company.

Leading and managing the Executive Directors and senior executives in the day-to-day running of the Company.

Leading the development, delivery and regular review of the Company's safety, operational and financial strategies and actions.

Developing an effective senior management team including establishing and maintaining effective succession planning for the senior executives of the Company.

Managing the effective implementation of the principles of corporate governance within the Company.

Leading the communications programme with stakeholders including, in conjunction with the Chairman, representing the Company.

Creating the conditions for overall Executive Director effectiveness, both inside and outside the boardroom.

Board

Being accountable to the Board for managing the creation and maintenance of proper financial and operational stewardship of the assets of the Company including internal controls, the implementation of the Board's decisions and the effectiveness with which the organisation works in accordance with the strategic objectives of the Company.

Running the executive function of the Board.

Developing and maintaining a close and effective working relationship with the Chairman, consulting regularly with him/her and keeping the Chairman advised of key issues relating to the Company.

Addressing the development needs of each of the Executive Directors with a view to achieving and maintaining their effectiveness as a member of the management team.

Maintaining the integrity of the Company by requiring that the Board's executive committees are properly structured and run and that all corporate governance matters are properly addressed.

Directors

Leading and managing the executive function of the Board including seeking effective performance of each of the Executive Directors.

Establishing and managing an effective relationship with each of the Non-Executive Directors.

Providing support and advice to each Executive Director while respecting executive responsibility.

Stakeholders

Developing and maintaining regular and effective communication and relationships with the Company's stakeholders including Network Rail Members and employees.

Establishing and managing effective and consistent delivery of the communication policy, strategies and statements of the Company as agreed by the Board to the stakeholders including Network Rail Members and employees.

Senior Independent Director

Steve Russell is the Senior Independent Director and is available to Members and other stakeholders should they have concerns that they are unable to resolve through normal channels of the Chairman, Chief Executive or other Executive Directors, or where these channels are inappropriate. He provides a sounding board for the Chairman as well as serving as an intermediary for the other Directors when necessary.

In addition, periodically Steve chairs a meeting of the Non-Executive Directors without the Chairman present at which the Chairman's leadership of the Board is discussed. His role also extends to providing leadership in relation to the appointment of a new Chairman when required.

Steve attended a variety of meetings with Members during the year and also has a personal email address which is publicised to all Members enabling them to make contact with him easily and quickly.

A Statement of Responsibility of the Senior Independent Director is published on Network Rail's website.

Non-Executive Directors

The Non-Executive Directors combine broad business and commercial experience (both from the rail industry and from other industry sectors) to enable them to challenge and contribute constructively to the development of the strategy of the Group. They also scrutinise the performance of management in meeting agreed goals and objectives and monitor operational performance of the business. Careful consideration has been given to the composition of the Non-Executive Directors with an aim to maximising the breadth of skills and experience as well as the mix of individuals holding executive positions and those who have retired from full-time employment in other companies (recognising the respective time commitment opportunities of both).

The following changes occurred during the year – joining the Board have been Malcolm Brinded in October 2010 and Bridget Rosewell in January 2011. Yvonne Constance and Christopher Green retired from the Board in July 2010. David Bailey retired from the Board in November 2010.

These new appointments, in addition to the appointments in 2010 and the appointment of Keith Ludeman to the Board with effect from July 2011, are intended to pave the way towards establishing a balance of experience and skill sets of those Non-Executive Directors both within and outside the rail industry. Keith Ludeman will bring his lengthy rail experience to join that of Graham Eccles', providing significant and relevant rail knowledge and first-hand, passenger-focused expertise to the Board. Malcolm Brinded and Bridget Rosewell complement this focus with their own respective experience gained in other industries.

The Board considers that each of the Non-Executive Directors is independent of the Company. With regard to the guidelines on the meaning of 'independence' as set out in the Code, however, it is appropriate to disclose that:

1. **Graham Eccles** – currently receives a pension from the Railway Pension Scheme, a scheme in which over 100 companies from the rail industry participate. The scheme is run by independent trust managers with trustees drawn from across the membership of the scheme (including from other companies within the scheme). Network Rail's membership of the Railway Pension Scheme is not considered to compromise Graham Eccles' independence given the structure of the scheme of which Network Rail is only one of many contributing companies. The Board considers therefore that Graham is independent.
2. **Christopher Green** – likewise currently receives a pension from the Railway Pension Scheme. The Board considers, however, that, for the reasons set out above in relation to Graham Eccles, Christopher is independent. Christopher retired from the Board in July 2010.
3. **David Bailey** – previously the Special Director appointed to the Board of Network Rail Limited by the Strategic Rail Authority (SRA) pursuant to its then rights under the Articles of Association of that company. Following the changes under the Railways Act 2005 with the responsibilities of the SRA passing principally to the Department for Transport (DfT), the DfT has not exercised its right to appoint a Special Director. The Board however wished to retain David as a Non-Executive Director as it considered that his wide-ranging commercial experience had enabled him to provide additional perspective and make a valuable contribution to the Company. David retired from the Board in November 2010.

None of the Non-Executive Directors are members of more than three committees of the Board except Steve Russell and Graham Eccles. Steve Russell is a member of the Nominations, Policy & Performance, Remuneration and Treasury Committees. Graham Eccles is a member of the Remuneration, Policy & Performance, Nominations and Safety, Health and Environment Committees.

A Statement of Responsibility of the Non-Executive Directors is published on Network Rail's website.

Induction, development and support

A development and awareness programme for all Directors is in place which can be summarised as follows:

Induction There is a comprehensive programme of induction for all new Directors aimed at equipping them so that they are fully conversant with their responsibilities as a Director and with the business of Network Rail. This includes a briefing, by the Group Company Secretary, on Network Rail and the rail industry, guidance on Board procedures and corporate governance matters. As part of this briefing, each Director is provided with a manual of key documents and background information. New Directors also meet with each of the Executive Directors, key senior managers and key stakeholders. The meetings seek to inform the Directors of the challenges, opportunities and risks faced by the business. Opportunities to visit operational sites are also provided. In addition, new Directors receive an induction on the safety, health and environmental matters of the Company. Further or follow-up meetings are arranged where a Director requires a deeper understanding on a particular issue.

Following his appointment as Chief Executive, David Higgins spent a considerable amount of time with the senior executive team being briefed on more operational matters before taking up his post in February 2011. Malcolm Brinded and Bridget Rosewell are currently completing their induction. The induction programme for the Board is reviewed regularly.

Development Directors are encouraged to update their skills, knowledge and familiarity with the Group through their ongoing participation at Board and Committee meetings, and through regular meetings with senior managers, other employees and Members. Briefings are given to the Board by members of senior management on key projects, organisational functions and governance or assurance processes adopted within Network Rail including major projects, strategy review, contracts and procurement, organisational effectiveness, corporate development and information management.

Board members regularly meet a cross-section of employees. In 2010/11 special gatherings were arranged for this purpose at locations in Edinburgh, Manchester, Cardiff and Birmingham. Non-Executive Directors have also joined Members on site visits including those arranged to visit Kings Cross and Thameslink projects in London and Forth Bridge in Scotland.

The Chairman of the Board also conducts his own programme of visits and staff meetings.

Additional personal development is available to all Directors. The Executive Directors and other senior executives undertook a leadership development course during the year. Plans are also being made to introduce a structured annual review of personal development needs for each Board Director.

Training Ongoing professional development is provided to Directors each year. Directors receive briefings on relevant issues including new developments relating to corporate governance, company law and other relevant legislation.

Directors are also encouraged to attend externally organised seminars on a range of topics designed to assist in equipping Directors with awareness of current legal, risk management or corporate governance issues and trends.

Support There is a procedure whereby Directors, wishing to do so in furtherance of their duties, may take independent professional advice at Network Rail's expense. During 2010/11 such advice was sought to review the processes for document exchange from Network Rail to the Office of Rail Regulation in relation to a safety related investigation.

Company Secretary

The Group Company Secretary is the secretary to the Board and the Board committees and is responsible for advising each of these, through their Chairman, on all governance matters. All Directors have access to the Group Company Secretary for advice on corporate governance, Board procedure and compliance matters. As well as supporting the Chairman with his responsibility for management of the Board and Board matters, the Group Company Secretary is also responsible for facilitating the induction and professional development of Board members and good flow of information within the Board, its Committees and between the Non-Executive Directors and senior management. The Group Company Secretary also acts as dedicated support to the Non-Executive Directors.

Board and Committee Attendance

Attendance by Directors at meetings during 2010/11 is set out in the table below.

The Chairman holds regular scheduled meetings with the Non-Executive Directors without the Executive Directors present to discuss the performance of the Company under the executive leadership. In 2010/11 the Non-Executive Directors met separately from the Executive Directors on three occasions.

Meeting attendance

Total number of scheduled meetings held during the year ended 31 March 2011 and the number of meetings attended of the maximum number that each Director was entitled to attend

	Board	Safety, Health and Environment	Nominations	Remuneration	Audit	Executive	Treasury	Policy and Performance
Number of meetings held	10	6	3	11	4	12	3	6
Attendance								
David Bailey[A]	7/7	4/4	2/2	7/8	3/3	–	–	2/2
Malcolm Brinded[B]	3/4	2/3	–	–	–	–	–	–
Patrick Butcher	10/10	–	–	–	–	12/12	–	–
Yvonne Constance[C]	3/3	–	–	4/6	1/1	–	–	–
Iain Coucher[D]	6/6	–	–	–	–	7/7	–	–
Graham Eccles	10/10	6/6	1/1	3/4	–	–	–	6/6
Mike Firth	10/10	–	–	11/11	4/4	–	3/3	–
Robin Gisby	10/10	–	–	–	–	11/12	–	–
Christopher Green[E]	3/3	1/2	–	2/6	–	–	–	–
Lawrie Haynes	8/10	5/6	–	–	0/2	–	–	4/6
Rick Haythornthwaite	10/10	–	3/3	11/11	–	–	–	6/6
Peter Henderson	10/10	–	–	–	–	11/12	–	–
David Higgins[F]	8/9	–	–	–	2/2	2/2	–	–
Simon Kirby	10/10	–	–	–	–	12/12	–	–
Janis Kong	9/10	6/6	1/1	–	4/4	–	–	–
Paul Plummer	10/10	–	–	–	–	12/12	–	–
Bridget Rosewell[G]	2/2	–	–	–	–	–	–	2/2
Steve Russell	9/10	–	3/3	11/11	2/2	–	3/3	6/6

A Stepped down from the Board on 30 November 2010.
B Joined the Board on 12 October 2010.
C Stepped down from the Board on 21 July 2010.
D Stepped down from the Board on 31 October 2010.
E Stepped down from the Board on 21 July 2010.
F Appointed Chief Executive on 1 February 2011, having previously been a Non-Executive Director since 1 April 2010.
G Joined the Board on 20 January 2011.

Notes

1 During 2010/11 there were a number of occasions where circumstances prevented a Director from attending a meeting in person. These occasions were a result of illness, adverse weather conditions and existing conflicting diary commitments, especially in respect of Directors newly appointed during the year or changes to the composition of the Committees. For future years, plans are in place aimed at minimising such diary conflicts.

2 Where a Director is unable to attend, it is usual practice for the Director concerned to review the papers and convey any views to the Chairman of the meeting in advance.

Safety, Health and Environment Committee Report

Members

Current members	From
Lawrie Haynes (Chairman from September 2010)	January 2010
Malcolm Brinded	November 2010
Graham Eccles	February 2010
Janis Kong	January 2010

Previous members	From	To
David Bailey*	February 2003	November 2010
Christopher Green**	June 2005	July 2010

* Stepped down from the Board in November 2010.
** Stepped down from the Board in July 2010.

The Chief Executive, Director, Asset Management, Director, Investment Projects, Director, Operations & Customer Service and Director, Safety & Compliance attend the meetings by invitation.

Role The Committee's role is to monitor the integrity of the methods of discharge of the safety, health and environmental responsibilities of the Company and to satisfy itself as to the adequacy and effectiveness of the safety, health and environment policies and strategies within the Company. It also reviews the principles, policies and practices adopted in complying with all statutory, sub-statutory, standards and regulatory requirements in respect of safety, health and environmental matters affecting the activities of the Group.

Its work in fulfilling its responsibilities includes:

- monitoring of the Group's safety, health and environment policies and strategies
- considering the areas of significant corporate and individual safety, health and environment risk and whether management is managing these effectively
- reviewing the structure, adequacy and effectiveness of safety, health and environment managerial committees within the Company including review of any terms of reference for the same
- reviewing the scope and results of any safety, health and environment audit on the effectiveness of the Company's safety, health and environment audit policies and strategies and such audit's cost effectiveness and the independence and the objectivity of the audit body
- considering the major findings of internal and external investigations and management's response thereto and, where necessary, with a view to the making of recommendations to the Board in respect of the same.

Process The Committee conducts its responsibilities through a series of scheduled meetings with forward agendas set each year to meet the responsibilities of the Committee. The Committee Chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting.

The Committee members are notified of any serious safety, health or environmental issues arising between meetings and they also receive safety reports between the scheduled meetings.

In addition to this Committee, and reflecting the recommendations in the Cullen Report, two executive committees consider strategic and tactical safety matters. The Board receives a report on safety, health and environment matters at each of its scheduled meetings.

Activities in 2010/11 The Committee met six times during the year. At each meeting, the Committee received a report on the safety, health and environment performance of Network Rail during the preceding periods and set out on pages 61 and 62 are its other principal activities.

The Safety, Health and Environment Committee's activities in 2010/11

Meeting	Agenda item
May 2010	• Update on where the current principal safety risks lie within the Operations & Customer Services function and how the risks are being mitigated and managed • Update on the progress of the Maintenance Restructuring programme reporting on the background to the restructuring, its contents and the processes adopted in its implementation • Report on the main safety risks and mitigations associated with delivery of train services during industrial action • Paper reporting on the status of the safety communications programme highlighting current activity and planned developments for the year • Paper detailing the status of employee wellbeing initiatives • Paper detailing the status of the Strategic Risk 1 (SR1) risk management reporting • Paper reporting on the status of health and safety risk management within the Transformation Programme
June 2010	• Presentation from the Office of Rail Regulation (the ORR) on its safety role and its views of Network Rail's safety performance during 2009/10 • Update on where the principal safety risks lie within the Engineering function and how the risks are being mitigated and managed • Presentation on the current status of an investigation into an incident and the resultant recommendations made • Outcome of a review by the Tactical Safety Group of irregular working events and actions for reducing risks of irregular working • Report on progress with implementation of the Railways & Other Guided Transport Systems (Safety) Regulations 2006 • Update on the processes for handling safety and health issues in the context of the Transformation Programme • Update on the status of potentially high risk train accidents key performance indicators • Proposal for carrying out a fundamental review of the effectiveness of the Network Rail Health & Safety Management System • Update on the current progress, challenges and initiatives relating to the key operational risk areas within the Operations & Customer Service function • Review of trends in Train Protection Warning System activations
September 2010	• Report on the environment assurance regime being developed for Network Rail and the recent review of the Environment Stewardship Index • Update on the findings of a review of RIDDOR-reportable workforce accidents • Report on a review of the Network Rail's safety culture and possible actions for enhancing the culture • Update on the status of investigations into each of the Tay Bridge, Forth Bridge and Moreton-on-Lugg fatalities • Update on the risk mitigation measures at level crossings • Report on the recent change made by the ORR in its management of Rail Accident Investigation Branch (RAIB) recommendations • Report on process for handling enforcement action issued by the ORR against Network Rail • Update on ongoing work on SR1 assurance map and integrated risk management review process • Review of safety risks in relation to the Transformation Programme
November 2010	• Discussion paper considering the way forward for the Safety, Health & Environment Committee • Update on progress with the review of RIDDOR-reportable workforce accidents • Update on the status of investigations into Tay Bridge and Forth Bridge fatalities • Oral update on the status of the level crossing risk mitigation initiative • Update on the work of the Infrastructure Maintenance function • Overview of Network Rail's safety assurance activities • Update on the annual reports from the Rail Safety & Standards Board (RSSB), the ORR and the RAIB • Update on where the principal safety risks lie within the Property function • Oral update on the Transformation Programme and the status of safety risk assessment within the programme

continued overleaf

The Safety, Health and Environment Committee's activities in 2010/11 continued

Meeting	Agenda item
January 2011	• Overview of broken rails performance in the year to date and possible options for reducing further risk and frequency of failures • Report on the details of the road vehicle incursion at Oxshott • Performance levels of contractor safety, key safety risks and safety leadership initiatives implemented by Network Rail, aimed at enhancing safety performance within its contractor community • Outline of a proposal for the introduction of a new safety awards scheme • Update on the status of the level crossing risk mitigation initiative • Overview of the current Signals Passed at Danger performance trends • Update on current status of implementation of Phase 2b and c restructuring in Maintenance • Update on the status of the RSSB review of RIDDOR-reportable accidents
March 2011	• Report on developments in understanding and improving the safety culture of Network Rail and its contractor workforce • Summary of the key health and safety issues within Network Rail • Recent developments in enabling a common approach to safety, health and environment risk management • Report on the background, categorisation and governance of irregular workings • Report on the new scoring system of Wrong Side Failures • Update on the progress of On Track Plant Safety project • Outline of the safety risk aspects and principal processes used to manage earthworks • Update on the process used for review of safety risk in relation to the Transformation Programme • Update on risk mitigation measures at level crossing following a national review of level crossing management • Update on current status of implementation of Phase 2b and c restructuring in Maintenance • Overview of Network Rail's safety assurance activities • Annual review of the terms of reference of the Committee, the general effectiveness of the Committee and its composition

Audit Committee Report

Members

Current members	From
Mike Firth (Chairman since January 2006)	December 2004
Lawrie Haynes	November 2010
Janis Kong	January 2010

Previous members	From	To
David Bailey*	October 2002	November 2010
Yvonne Constance**	September 2005	July 2010
David Higgins***	April 2010	January 2011
Steve Russell	September 2009	September 2010

* Stepped down from the Board in November 2010.
** Stepped down from the Board in July 2010.
*** Became Chief Executive in February 2011.

The Chairman of this Committee has a strong and lengthy financial background and has experience of chairing a listed company's audit committee. Mike Firth is also a Fellow of the ifs School of Finance and an Associate of the Chartered Institute of Bankers.

The Chief Executive, the Group Finance Director, the Head of Internal Audit and Head of Insurance and Risk attend meetings of the Committee by invitation. Two representatives from the external auditors also attend each of the meetings and periodically meet with the Committee without executive management present.

The Board continues to be satisfied that the composition of the Committee fulfils the Code's requirement that at least one member of the Committee has recent and relevant financial experience. It also considers that it complies with the Smith Guidance on Audit Committees in all material respects.

Role The main responsibilities of this Committee are to monitor the integrity of the financial reporting and the audit process and to monitor that an effective management and internal control system is maintained. The Committee has a structured programme of activities including receipt of regular detailed reports on relevant aspects of management, focused to coincide with key events of the annual financial reporting cycle.

Its work in fulfilling its responsibilities includes:

- reviewing the internal control framework and the register of financial and non-financial risks (so far as these are not reviewed by other Board committees such as the Safety, Health and Environment Committee)
- monitoring financial reporting policies and practices and compliance with accounting standards
- reviewing significant accounting estimates and judgements
- reviewing interim and annual financial statements before publication
- considering and making recommendations to the Board in relation to the appointment, reappointment and removal of the external auditors following its assessment of their independence and objectivity (including the safeguards that are in place to maintain such independence) and their terms of engagement and remuneration
- reviewing the internal and external audit process including the scope of the planned audits and the audit findings
- reviewing the policy and procedure whereby employees can raise, in confidence, concerns about possible improprieties.

Process The Committee conducts its responsibilities through use of a series of scheduled meetings with a forward agenda and a defined set of items of business for each meeting. The Committee Chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting. Between meetings, the Committee Chairman reviews emerging issues as appropriate with the Group Finance Director and other senior managers.

The Audit Committee's activities 2010/11

The Committee met four times during the year. At each meeting, the Committee receives regular reports including a report on the output from the Internal Audit function's recent programme of work and a Risk Management report which provides a summary of risk management within Network Rail including the risks identified to be high and the status of their mitigation, visibility of the current risk profile and changes in that risk profile during the year, update on the work that has been undertaken on the review of several strategic risks, update of key risks and actions for the Transformation Programme, which is concerned with the failure to deliver the benefits of the change programme.

The Audit Committee's activities in 2010/11

Meeting	Agenda item
May 2010	• Paper on the key issues and areas of judgement relating to the financial statements of Network Rail Limited and Network Rail Infrastructure Limited • Report from Network Rail's external auditors on the 2009/10 audit including the audit process and key audit matters identified • Paper by the Head of Internal Audit on the basis and rationale to support the internal control statement for inclusion in the Annual Report and Accounts 2010 • (In the absence of the executive management from the meeting) the views of the external auditors were sought as to whether there were any other issues arising from the audit for 2009/10 or relating to the management of the Company that they wished to raise with the Committee • Paper requesting approval for the provision of non-audit services by a company acquired by the external auditors • Annual review of the terms of reference of the Committee, the general effectiveness of the Committee and its composition
September 2010	• The external auditors' interim review plan for the period ending 30 September 2010 • Paper on the status of review of the integrated risk management, outlining a draft Risk Policy • Proposal for the internal audit plan for 2010-12 from the Head of Internal Audit • Overview of the induction programme proposed for the new external auditors • Paper reporting on the status of discussion with the Financial Reporting Review Panel on Annual Report and Accounts 2009
November 2010	• Paper outlining the key issues and areas of judgement relating to the interim financial statements of Network Rail Limited and Network Rail Infrastructure Limited for the six months ended 30 September 2010 • Report from the external auditors on the 2010/11 interim review • Paper on the status of review of the integrated risk management
February 2011	• Proposed timetable for production of the 2010/11 statutory accounts • External auditors' year end audit plan, the proposed fees and the scope of the audit (including the key business risks which will be the focus of the audit) and the management letter • A summary update of the controls review being undertaken by the external auditor as part of the year end audit programme • Paper on the status of review of the integrated risk management • Annual review of the terms of reference of the Committee, the general effectiveness of the Committee and its composition • Paper outlining the initial observations of the internal review into IM Projects Management • Update on the Code of Business Ethics, a summary of the new Bribery Act and a description of the additional measures that Network Rail is putting in place to reinforce its existing internal controls and seeking approval of the revised framework

Internal control

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. It can only provide reasonable (rather than absolute) assurance against material misstatement or loss.

The Board considers the management of risk and internal control to be fundamental to achievement of the Company's objectives and has formally established a risk management standard for identification, evaluation and ongoing review of the significant risks faced by the Group which accords with the Turnbull Guidance. During the year the Executive Directors have formally reviewed the key risks faced by the Group. The Audit Committee, on behalf of the Board, keeps the effectiveness of the system of internal control under review and has done so throughout the year.

The risk management process forms an integral part of the Network Rail planning and review activity. Risks impacting safety, reputation, performance and financial value are actively managed. Risk management processes incorporate the following:

- the identification of risks to the achievement of business objectives by all business units and major projects together with the likelihood/impact analysis and the development of mitigation actions to manage risks at the desired levels
- a Company Standard for risk management to provide consistency of approach across business units
- a self certification process which requires function heads to confirm that risk management processes are being complied with and that their risk data is accurate and complete
- the capture and recording of risks, risk scoring and action plans in a Company-wide risk management system
- the regular reporting and review of business unit and major project risks by the Executive Directors at monthly business reviews
- the peer review of causal risk maps which provide an overview of strategic risk interaction across functions and support regular review of the risk profile by the Audit Committee and the Board
- the inclusion of risk assessment into investment planning processes using the corporate risk matrix scoring system
- the risks associated with the Transformation Programme have been identified and are regularly reported and reviewed by the Transformation Programme Steering Group and the Board.

There are established internal control procedures for managing the risks faced by the Group. The key elements are:

- a Code of Business Ethics, supported by Human Resources procedures, that defines expected standards of behaviour
- regular structured reviews of all business units and major projects by the Executive Directors assessing progress against objectives with action being taken as required
- a framework of delegated authority and accountability based on a templated organisation structure
- Board approval of business strategies and objectives, together with plans, annual budgets and targets
- the periodic reporting of financial results, safety and other operational performance indicators, including an Executive Key Performance Indicator dashboard
- procedures for planning, approving and managing all investment expenditure including the use of the Governance to Railway Investment Projects (GRIP) specifying the requirement and timings for approvals sought from the Investment Panel and, where above its delegated financial level, from the Executive Committee and the Board
- Financial Regulations governing the accounting and stewardship of all financial transactions
- centralised treasury operations acting within defined limits and overseen by the Treasury Committee
- monthly accounting reviews to scrutinise financial data and increase confidence in the integrity of the accounts
- a Sourcing and Supplier governance framework which sets out standards for contracting and procurement
- continuous monitoring by the Legal Services function within the Company of claims and litigation issues affecting the Group as well as the identification of changes in the law or regulations which impact on the Company's activities
- governance of business change initiatives through the Executive Transformation Steering Group
- commitment to continuous improvement in levels of competence via leadership, competency and training programmes and a performance appraisal system linked to the Network Rail Promise and Principles
- appropriate cover for insurable risks
- business continuity and disaster recovery plans for key operational assets, corporate offices and IT applications
- policies and practices for detecting, reporting and preventing fraud and serious breaches of business conduct.

Internal audit

The Company has an independent Internal Audit team whose primary role is to provide objective and independent assurance regarding the adequacy of the Group's internal control framework and compliance with policies, laws and regulations. Internal Audit is also responsible for reviewing the effective operation of the Company wide risk management system as well as improving processes, providing advice and proliferating best practice.

The work of Internal Audit is focused on the areas of priority as identified by risk and materiality analysis and is in accordance with an annual audit plan which is approved by the Audit Committee. The Audit Committee receives regular reports on audit findings from the Head of Internal Audit, who has direct access to the Chairman of the Audit Committee. Recommendations to improve the internal control framework are reported to the Audit Committee through this process.

The Internal Audit function works closely with the external audit team and other assurance providers to facilitate the co-ordination of audit plans and the optimisation of audit resource. The Head of Internal Audit liaises with the External Auditor on a regular basis.

The Company also has an established process by which staff may, in confidence, raise concerns about possible improprieties. Matters arising from the investigation of fraud are reported to the Audit Committee by the Head of Internal Audit. There is an ongoing programme undertaken by Internal Audit to raise awareness of fraud issues with management.

During the course of its review of the system of internal control, the Board has not identified nor been advised of any failings or weaknesses which it has determined to be significant. Nevertheless, the Board recognises that there is still an ongoing need to build on the above framework and uses the opportunity to review internal control processes against incidents when they arise in order to promote continual improvement of the internal control system.

External auditors

Independence and objectivity of the external auditors is of great importance and the Committee has put in place safeguards to protect auditor objectivity and independence. It has established, therefore, a policy to assist this whereby employment of the external auditors on work for Network Rail is prohibited, other than audit services or tax consulting services, without prior approval by the Audit Committee. The Committee oversees compliance with the policy and considers the infrequent requests to use the auditor for non-audit work.

Furthermore, to enhance independence and in line with established auditing standards, a new lead partner of the external auditors is appointed every five years, with other key audit principals within that firm rotated every seven years.

The Committee has responsibility for advising the Board on the appointment, reappointment and the remuneration of the external auditors. Following an extensive tender process concluded in 2010 PricewaterhouseCoopers LLP (PricewaterhouseCoopers) were recommended by the Audit Committee for appointment as the Company's external auditors at the AGM in July 2010. The recommendation received a substantial majority vote of support at the AGM.

In May 2011 the Committee recommended to the Board that PricewaterhouseCoopers be presented for reappointment as the Company's auditors at Network Rail Limited's AGM in July 2011. The Board accepted the recommendation. The Notice of the 2011 AGM of Network Rail Limited includes, therefore, a resolution to this effect.

Nominations Committee Report

Members

Current members	From
Steve Russell (Chairman from November 2010)	November 2008
Rick Haythornthwaite (Chairman to June 2010)	March 2009
Graham Eccles	July 2010
Janis Kong	July 2010

Previous members	From	To
David Bailey*	October 2002	November 2010
David Higgins** (Chairman June 2010 to October 2010)	June 2010	October 2010

* Stepped down from the Board in November 2010.
** Stepped down on announcement of his appointment as Chief Executive.

Rick Haythornthwaite (Network Rail Board Chairman) chaired the Committee for part of the year whilst the Non-Executive Director Recruitment continued. David Higgins was appointed Chairman of the Committee prior to him asking to be considered for the role of Chief Executive during the summer of 2010. Once he did so he did not participate in the selection process for that role. Steve Russell took over chairmanship of the Committee in November 2010. Throughout the year, the other members of the Committee were independent Non-Executive Directors.

The Committee asks the Chief Executive and Group HR Director to attend certain of its meetings.

Role The role of the Committee includes:

- reviewing regularly the size, structure and composition of the Board and making recommendations to the Board
- evaluating the balance of skills, experience, independence and knowledge of the Board
- identifying and nominating candidates for appointment to the Board
- satisfying itself that appropriate succession planning is in place.

In May 2011 the Network Rail Board approved extension of the remit of this Committee to encompass corporate governance.

Activities in 2010/11 The Committee met three times during the year and its main focus was on managing the search for new Non-Executive Directors. A special sub-committee of the Committee was set up to identify a new Chief Executive to succeed Iain Coucher.

Non-Executive Directors' recruitment

The Committee reviewed the long-term succession plans for Non-Executive Directors in 2010 looking at the balance of skills and experience available to the Board as well as the composition of the Board committees. As a result of this review, and in consultation with its stakeholders, the Committees drew up competencies profiles for each of the Non-Executive Director positions.

Two firms of external search consultants, Egon Zehnder International (EZI) and Korn/Ferry Whitehead Mann (KFWM), were engaged to draw up a diverse long list of possible candidates for the various roles identified. Following further review, short-listed candidates met with Committee members and candidates for nomination to the Board were identified. During the year, Bridget Rosewell and Malcolm Brinded were appointed to the Board to serve as Non-Executive Directors. It was also announced in February 2011 that Keith Ludeman will join the Board in July 2011.

The terms of their appointments are detailed in the Remuneration Report.

The Chairman of the Committee reported periodically to the Members of Network Rail Limited and other key stakeholders during the year on the views of the Committee and progress of the search. In a series of letters to Members of Network Rail, also circulated to key stakeholders, the competencies profile of each of the Non-Executive Director positions identified by the Committee as being appropriate were provided. This accompanied the personal attributes expected for a Non-Executive Director position and explanation of the details of the recruitment process being adopted. Members (and other stakeholders) were invited to comment on these.

Upon selection by the Board, the Chairman has also given Members written explanation and rationale to the individual's appointment.

Appointment of a new Chief Executive

The CEO recruitment sub-committee commenced the search for a successor to Iain Coucher by drawing up the role requirements for the Chief Executive position, after seeking the views of the rest of the Board, the Company's Members and other stakeholders. In particular, Members' consultation included one-to-one personal contact, to ascertain what they consider to be the core attributes and career experience the Chief Executive of Network Rail requires.

The sub-committee comprised David Bailey, Graham Eccles, Janis Kong and Steve Russell and was chaired by Rick Haythornthwaite. Because of his experience in the role, Iain Coucher was also asked to provide input in the selection.

A person specification for the role was drawn up and then EZI and KFWM were engaged to identify candidates against this specification from FTSE 350 companies, large UK private companies, international companies and consultants databases and networks.

In particular a wide range of relevant industry sectors were considered and, in parallel with this, an advertisement was placed, on behalf of Network Rail, in the *Sunday Times.*

Candidates from both recruitment methods were identified and interviewed by the sub-committee. Having fully tested the market and assessed all candidates against the role requirements, the sub-committee agreed to recommend to the Network Rail Board the appointment of David Higgins as Chief Executive.

An announcement was made on 28 September 2010 that David Higgins would succeed Iain Coucher on 1 February 2011, following a transition and handover period.

Evaluation of Board performance

The Nominations Committee is charged by the Board to review annually the performance of the Board, its principal committees and individual Directors. The policy adopted by the Nominations Committee is for external assistance to be provided in conducting the review on a bi-annual basis. In the interim year the review has been conducted internally by the Group Company Secretary.

For 2011 the evaluation process has commenced with the design of a service brief and selection of an external evaluation provider. The evaluation will assess the collective performance of the Board and each of its committees as well as evaluate the contribution, effectiveness and commitment to the role of each of the Directors (including commitment of time for Board and Committee meetings and any other duties).

The evaluation process has been designed and based on an assessment of the following aspects of Board activities:

1 Board performance against the aspirations contained within Network Rail's Governance Principles – set out on page 71

2 Board performance against the provisions contained within the UK Corporate Governance Code

3 Functional effectiveness of the Board and its Committees including the effectiveness of the processes by which the Board is held to account by its stakeholders.

The evaluation will include interviews with each Director, Company Secretary and a selection of stakeholders to include a selection of Members of Network Rail, Chairman of the Office of Rail Regulation and other key stakeholders.

The evaluation was commenced in May 2011 and is scheduled to be completed by early summer 2011. A report will be presented to the Chairman of Network Rail which will comprise an executive summary, details on the performance of the Board and its Committees and details on each Board Director.

The executive summary will report at a high level on the collective performance of the Board and each of the Committees and will be presented to all Board Directors and published to Members and other stakeholders.

A separate report on the Chairman will be written and presented to the Senior Independent Director.

In addition to the overall evaluation, and in accordance with the terms of reference of the Board Committees, each Committee reviews its performance against its responsibilities under its terms of reference each year. In February 2011, the Committees each undertook their own assessment. This included considering the terms of reference as to their continuing appropriateness and effectiveness, the composition of the Committee, the number of meetings scheduled and the contents of the meetings. Each Committee concluded that it was satisfied with its performance and composition including the current level of resourcing available to perform its responsibilities under the terms of reference noting the developments and enhancements undertaken in 2010/11.

Board committee membership

The Committee is responsible for nominating appropriate individuals for membership of the Board's Committees. A number of changes were made to Committees during the year to reflect changes to the composition of the Board and in order that the Committees comprised individuals with the appropriate skills, knowledge and experience, and also that they comply with the requirements of the Articles of Association of Network Rail Limited and the requirements of the network licence.

Executive management succession planning

The Committee is responsible for reviewing the plans and processes aimed at ensuring that the Company has a senior executive resource with the necessary skills and experience to meet Network Rail's future needs. Periodically the Committee receives a detailed report on senior executive planning and development processes. This covers the succession plans for key operational and functional positions (including existing Executive Director appointments).

The Nominations Committee's activities in 2010/11

Meeting	Agenda item
April 2010	• Review of the status of the search for new Non-Executive Directors – Engineer and Rail Experience • Outside position request by Graham Eccles in relation to a non-executive position at Virgin Healthcare
June 2010	• Review of the composition of the Nominations Committee • Process for selecting a new Chief Executive* • Review of the status of the search for new Non-Executive Directors – Engineer
December 2010	• Agreeing the recommendation for the appointment of Non-Executive Directors

* A sub-committee was then established to progress recruitment – see page 67 for details.

Policy and Performance Committee Report

Members

Current members	From
Bridget Rosewell (Chairman from January 2011)	January 2011
Rick Haythornthwaite (Chairman to December 2010)	January 2010
Graham Eccles	March 2010
Lawrie Haynes	March 2010
Steve Russell	January 2010

Previous members	From	To
David Bailey *	January 2010	November 2010

* Stepped down from the Board in November 2010.

The Chief Executive and Director, Planning and Development, and occasionally with other Executive Directors, attend by invitation.

Role The role of the Committee includes:

- monitoring the quality, scope and integrity of the long and short-term planning
- monitoring operational and project risk management of the Company
- promoting within the Company a systems approach to resource and risk management
- seeking reassurance that performance metrics used in the Company are appropriate, for the purpose of seeking timely, effective solutions to the objectives of the Company
- monitoring the status of stakeholder goodwill and the Company's approach to stakeholder relationships, with particular emphasis on the Company's customers and their customers
- investigating or advising on the above or any related matters that are referred to it or as may appear to it to be necessary.

Process The Committee conducts its responsibilities through a series of scheduled meetings with a defined set of items of business for each meeting. The Committee chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting.

Activities in 2010/11 The Committee met six times during the year and its principal activities are set out below.

The Policy and Performance Committee's activities in 2010/11

Meeting	Agenda item
May 2010	• The potential scope for open access competition and approaches to structure of charges • The planning of power supplies for electric traction across the network, both for the short-term (CP4) commitments and for the longer term • Network Rail's multiple interfaces with Government's High Speed Rail proposals and the operational and strategic impact • The components of the Cost Efficiency Measure KPI
June 2010	• Key considerations in relation to the future of Network Rail following the establishment of a new Government and subsequent discussions with Department for Transport
November 2010	• Progress on the Periodic Review 2013, the Planning Ahead programme of work with the industry, the development of the Initial Strategic Business Plan and discussions with the Department for Transport and Transport Scotland on development of the High Level Output Specifications (HLOS) • Network Rail's response to the Government's High Speed Rail scheme • Review of the Capacity KPI, including CP4 HLOS capacity metric, the CP4 volume incentive, our capacity KPIs and PIs, and the current discussions on how capacity could be defined in the CP5 HLOS • Security of electricity supply for rail infrastructure systems including the electricity purchase strategy employed by Network Rail
December 2010	• Infrastructure Investment project delivery options, costs and benefits compared with current approach to delivery • Status of discussions with the McNulty Value for Money team, Government and other stakeholders

continued overleaf

The Policy and Performance Committee's activities in 2010/11 continued

Meeting	Agenda item
January 2011	• Development of supplier engagement models for delivery of Infrastructure Investment projects • Operating strategy which forms a key part of the baseline plan contained within the Initial Industry Plan (IIP) • Purpose and content of the IIP to be published in September 2011 and the Strategic Business Plan to be published in January 2013 • Milestones for Devolution and Partnerships including the status of discussions with the rail industry
March 2011	• Update on the progress against CP4 delivery plan, compliance with other regulatory obligations and reform of the industry regulatory and contractual framework • Update on the development of the IIP including the Planning Oversight Group's letter to IIP, the baseline cost of the railway in CP5 and developing the preferred plan • Process sector of the Corporate KPI dashboard, providing an update on the current status of the review • Update on the status of the internal devolution programme including the announced Wessex and Scottish pilot schemes • Process for developing partnership arrangements with train operators • The annual review of the terms of reference of the Committee, the general effectiveness of the Committee and its composition

Treasury Committee Report

Members

Current members	From
Mike Firth (Chairman from December 2004)	December 2004
Steve Russell	July 2008

The Chief Executive, Group Finance Director, Group Treasurer and Deputy Group Treasurer attend meetings by invitation.

Role The Committee's role is to review and satisfy itself as to the appropriateness of proposed treasury transactions including banking, cash management, debt raising and management and investment management.

Process The Committee conducts its responsibilities through a series of scheduled meetings. The Committee Chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting. Between meetings, the Group Finance Director updates and discusses with the Committee Chairman matters relating to the treasury activities.

Activities in 2010/11 The Committee met three times during the year and its principal activities included the following shown in the table below.

The Treasury Committee's activities in 2010/11

Meeting	Agenda item
August 2010	• Update on the Company's debt issuance and investment portfolio • A progress report on current and forecast fixed:floating debt ratios and a valuation of the existing hedging portfolio • Summary of the clearing bank contract review undertaken in June 2010 • Update on the process and status of the review of the Treasury Policy Manual
November 2010	• Update on the Company's debt issuance and investment portfolio • A progress report on the current and forecast fixed:floating debt ratios and a valuation of the existing hedging portfolio • Update on the next steps to corporate debt issuance
February 2011	• Update on the Company's debt issuance and investment portfolio • A progress report on the current and forecast fixed:floating debt ratios and a valuation of the existing hedging portfolio • Report on the status of the Treasury Risk Register • The annual review of the terms of reference of the Committee, the general effectiveness of the Committee and its composition

Engaging with Members

Being a wholly owned subsidiary, Network Rail Infrastructure Limited does not have external shareholders. As a company limited by guarantee (CLG), however, its ultimate parent, Network Rail Limited has Members, instead of shareholders, to whom the Board is accountable. Members have the same rights and powers as shareholders though they do not have any financial interest in the Company. They are also not remunerated for their role.

To assist Members to perform their role a set of 10 principles (Network Rail's governance principles) has been drawn up which describes the basis of the role of Members and the measurement by which the Board of Network Rail can be judged in relation to how it runs the Company and against which the Board should be held to account. The quarterly governance letters written by the Chairman of the Board to the Members addresses the work of the Board against the principles.

Of the 92 current Members, there are two principal categories – Industry and Public Members. Industry Members have a right of automatic membership if they meet the eligibility criteria set out in the Articles of Association. An independent panel, the Membership Selection Panel (MSP), has responsibility for conducting the recruitment and selection process for Public Members.

Network Rail's governance principles

Principle 1: Safety
The Company should regard the safety of all those working and travelling on the railways as its paramount duty, using the principle of ALARP (As Low As Reasonably Practicable) to support this.

Principle 2: Leadership
The Company should drive for extraordinary performance in the short-term as well as look to the future, providing clear leadership in the rail sector in both its facilitation of a widely shared vision and its approach to stakeholder relationships, reputation and societal impact.

Principle 3: Setting targets
The Company should benchmark itself against the best in the world in all activities (including estate management), setting targets that aspire to be or continue to be the best. It should actively seek ways to calibrate its benchmark position and offer clear justification wherever ambitions fall below stakeholder expectations. The targets should always be positioned to motivate a delivery of performance that exceeds expectations and encourage thoughtful questioning of fundamental and potentially constraining business assumptions.

Principle 4: Delivery and risk management
The Company should have the appropriate structures, processes and systems in place to be assured of delivering its primary governance responsibilities and ambitions, including the demands of its licence and other legal, regulatory and contractual requirements and commitments. These systems should include an explicit framework of plans and accountabilities, a comprehensive risk management approach and an effective network of internal communication and information flows.

Principle 5: Decision-making
The Company should seek that all investment and operational decisions will achieve an appropriate balance of improved safety, reliability, capacity, availability, respect for the environment and value for money, both separately and collectively. It should carefully and proactively manage situations where short-term disruptions to customer service are considered necessary to deliver long-term benefit.

Principle 6: Performance and incentives
The Company should have cost-effective performance evaluation and incentive systems in place to attract and retain high-calibre managers as well as incentivise those managers to deliver beyond the demands of the current Control Period and with the best long-term interests of the public, freight users and taxpayers in mind.

Principle 7: Employees and the organisation
The Company should, in all its decisions and actions, have respect for its employees and their health and well-being, while also continuously seeking to adapt the organisational shape, processes and culture in a planned and measured fashion to meet its evolving ambitions and challenges.

Principle 8: Financial flexibility
The Company should, as a matter of prudence, consider its expected capital availability as being subject to change, always seeking to generate surplus cash flow beyond target levels, diversify capital-raising options and adapt activity as required without, if possible, compromising on future delivery or commitments to other funders, including taxpayers.

Principle 9: Licence to operate
The Company should seek continuously to develop and demonstrate to all stakeholders the relative advantages of a regulated private company undertaking a public service role over other governance models. In other words, it should never take its licence to operate for granted.

Principle 10: Governance and development
The conduct of the Network Rail Board of Directors will be shaped according to these Governance Principles and the most recent UK Corporate Governance Code issued by the Financial Reporting Council. The Board will commission an independent review of its conduct and development which will be published prior to each AGM.

How does Network Rail engage with its Members?

A variety of forms of contact with Members is used to help Members hold the Board to account for the performance of the Group and to help Members to be aware of and understand developments within the business.

Members' induction

New Members attend a workshop on the activities of the Group and its businesses. The topics covered in the workshop can be summarised as follows:

- governance structure and their contribution as Members
- role of the Board
- update on the recent activities of the existing Members
- external governance debate and role of Network Rail's stakeholders in the debate
- the delivery outputs expected from Network Rail during the relevant control period.

Extensive resource material is also available to new Members to familiarise themselves with Network Rail and the rail industry provided by both Network Rail through the Members' dedicated website and its general website, as well as through other sources including the website of the Office of Rail Regulation.

During membership

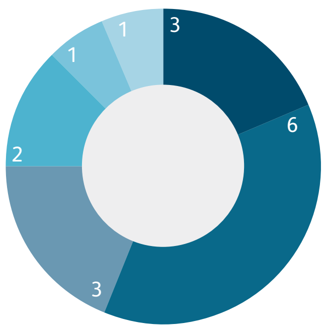
Network Rail believes that transparency of the business is important, so too is the opportunity for Members to actively participate in discussion on the issues facing the Company. To enhance the opportunities for greater transparency and participation a number of other approaches have been adopted:

- **Full Annual Reports and Accounts and Interim Results** are published and issued to Members for both Network Rail Limited and Network Rail Infrastructure Limited.
- Members meet the Board at the **Annual General Meetings** (AGM) (and, if needed, other General Meetings) at which Network Rail takes the opportunity to give presentations on specific topical matters and discuss these with Members. There is an opportunity to meet and discuss matters with the Directors both before and after the meetings as well as to ask questions at the meeting (including by submission of written questions in advance).
- **Half yearly meetings** are held in order for the Board to discuss the half year results with Members.
- Twice yearly **meetings of the Chief Executive with Members** (after announcement of full and half year results), allowing Members to probe performance issues.
- **Regular Members' briefings** covering specific topics allow active discussion with Network Rail and other Members on key issues. Members are encouraged to propose topics for briefing or discussion. During the year, the topics of these briefings included an update on work and discussions on the future of the rail industry, accountability and governance review, results of the Members' survey, the McNulty value for money review, seasonal operational performance and Christmas/New Year infrastructure investment.
- Annual **meeting between the Office of Rail Regulation and Members** at which they discuss the regulator's views on the current performance of Network Rail against its regulatory obligations.
- **Site visits** to give Members insight into key aspects of the running of the business. During the year, site visits were arranged to visit Kings Cross and Thameslink projects in London and Forth Bridge in Scotland.
- **Conference calls** are used to consult with Members on ad hoc, more immediate issues. During the year there were conference calls held to discuss Executive Directors' incentive schemes, interest rate hedging, Network Rail's efficiency measure, pensions briefing, the recruitment of the new Chief Executive and also the recruitment process for new Public Members.
- **Consultation** with Members as part of Network Rail's **accountability and governance review** launched in December 2010.
- A **Members' survey** was carried out during the year which, amongst other things, explored the issues around communication between Network Rail and Members including the use of the Members'-only website. Results of the survey were considered by the Chairman and the Board.

The chart below illustrates the Members' events which took place during 2010/11.

Allocation of Members' events during 2010/11

Site visits	
Conference calls	
Briefings	
General meetings	
Discussions with Chief Executive	
Meeting with the Office of Rail Regulation	



Moreover, in addition Network Rail also:

- Designs a **scheduled programme of the Member events** for each year which is circulated in advance to Members.
- Provides **quarterly governance letters** written by the Chairman of Network Rail on the Board's work over the preceding three months and key governance topics facing the Company.
- Employs a person specifically for the purpose of providing information to Members, and responding to Members' queries, as well as arranging for Members' comments to be passed on to the appropriate person in the Company for response (**Members' Executive**).
- Supports the **Members' Co-ordinator** who is elected from amongst Members to facilitate effective communication between Members and Network Rail, for example through discussion on the agenda contents for key meetings to allow the Members to input into the matters addressed in those meetings.
- Provides a **Members' website** onto which important and useful documents (including quarterly reports from the regulator on the performance of Network Rail) are posted by Network Rail and on which Members and the Company are able to post comments/correspondence.
- Provides a **Members'-only website** for Members to communicate on-line between themselves. This site is not accessible by Network Rail.
- Provides an **information resource facility** within the Members' website with information and links to other information sources relating to Network Rail and the rail industry.
- Arranges for Members to receive automatically relevant **press releases**, staff magazine and other relevant publications.
- Offers **subscriptions** to certain rail sector periodicals.
- Provides facilities for **Members'-only meetings** at which Members discuss key issues amongst themselves without the presence of Network Rail.
- From May 2011 **publishes** Board and Board Committees' **minutes and agendas** to the Members of Network Rail.

Annual general meetings (AGMs)

Each year, Network Rail Limited, being the parent company of the Group, holds an AGM and the business of the AGM is separated out into single resolutions. The business of each AGM will usually include:

- receiving the Annual Report and Accounts
- appointment/reappointment of auditors
- appointment/reappointment of Directors
- appointment of the members of the Membership Selection Panel
- approval of the Directors' remuneration report
- approval of the long-term element of Executive Directors' incentive schemes.

Members have also requisitioned resolutions at the majority of the AGMs since 2004 on a range of topics relating to operational performance and reporting, Members' governance arrangements and incentive awards.

Poll voting is adopted for all resolutions. The level of proxy votes received for the AGM is disclosed together with details of the votes for, against and the abstentions for each resolution. The Chairmen of the Board Committees are also available at the AGM to answer questions in relation to their Committee's area of responsibility.

The Notice of the AGM and any related papers are sent out to Members with the aim of arriving at least 20 business days before the date of the meeting thus ensuring that Members have sufficient time in which to consider the items of business.

The next AGM will be held on 21 July 2011. In accordance with best practice all the Board of Network Rail will be standing for election or re-election at the AGM. Their details are set out on pages 28 and 29. Further information on each Director seeking election or re-election will be given in the documents accompanying the Notice of the AGM to be sent to Members of Network Rail Limited.

Attendance at Network Rail's AGM has been high for each year since its creation. In 2010, for example, 77 of the then current 100 Members voted.

Relations with other stakeholders

The Board of Network Rail is extremely committed to, and recognises the importance of developing and maintaining, an ongoing relationship based on regular communication and dialogue with its wide range of stakeholders. Satisfying customers (the passenger and freight train operators), users of the railway, its funders and other stakeholders must be at the heart of Network Rail's business delivery.

Emphasis is placed, therefore, on developing existing relationships as well as expanding the breadth of relationships. This includes the Chief Executive, other Executive Directors and functional Directors (together with many other senior managers) having regular meetings with representatives of the Office of Rail Regulation (as both economic and safety regulator), passenger and freight train operators and other rail stakeholders. Scheduled meetings are held with the Department for Transport and train operators to discuss industry-wide issues. Dialogue is continuous between Executive Directors of Network Rail and throughout the Company with each of our customers – the passenger and freight operators. Dedicated executive resource is given to each customer. Monthly monitoring of performance on a customer-by-customer basis and on relationships between customers and Network Rail are reviewed by the executive management team. Action plans are drawn up with each customer seeking to address key issues as well as commitment by both parties to formal joint performance improvement plans.

Various approaches are used to monitor the satisfaction of customers, rail users and other stakeholders within an overall performance management framework. Independent relationship surveys are conducted regularly with each of the customers (the train operators), passengers and freight end users and suppliers. Moreover, customer satisfaction has been a formal consideration under the Management Incentive Plan.

In addition various forms of formal consultation with key stakeholders takes place on many aspects of Network Rail's activities, run either directly by Network Rail, by the ORR or by others.

During the year, four Board meetings were held outside London – in Edinburgh, Manchester, Cardiff and Birmingham. These visits also provided the Board with opportunities to hold feedback meetings with stakeholders – local business leaders and employees. Further stakeholder events have been scheduled for 2011/12.

Also, developing on the existing site visits schedule, Non-Executive Directors are encouraged to visit Network Rail sites as well as maintain their relevant contacts related to the rail industry and its wide stakeholder base. Arrangements are also made for new Directors coming into Network Rail to meet with key stakeholders as part of their induction programme.

Network Rail needs to work closely with all types of community representatives and so, as part of its normal day-to-day routine activities, Network Rail regularly briefs many different bodies and individuals. This includes the Company having a significant amount of contact with a wide range of elected representatives (Members of Parliament, Members of the Scottish Parliament, London Assembly and Welsh Assembly, Members of the European Parliament and others) as well as non-governmental organisations, pressure groups and campaigning organisations. This includes meetings to discuss issues facing the Company and those using the railways, both passengers and freight traffic nationally and regionally. Opportunity is also taken each year to explain to elected representatives the Company's business plans, performance and significant developments within the business. This is sometimes best achieved through the Company organising briefings and similar functions at which presentations are given as well as site visits.

The Network Rail Stakeholder Relations Code of Practice was launched in March 2010. This code of practice forms a fundamental part of how Network Rail intends to improve its business performance over the next five years and is firmly aligned with its ongoing programme to create a service culture within the Company. Network Rail aims to be seen as a great company to do business with and which delivers on its promises. The Code of Practice aims to go part of the way to satisfying this ambition, by recognising that in order to give stakeholders a better experience Network Rail needs to pre-empt and respond to their needs.

The overarching principle of the Code of Practice is that Network Rail will aim to deal with stakeholders:

- in an efficient and timely manner
- with the skill, diligence, prudence and foresight that is expected of us as a skilled and experienced network facility owner and operator.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements. The Directors are required to prepare financial statements for the Group in accordance with International Financial Reporting Standards adopted for use in the European Union (IFRSs) and have also elected to prepare financial statements for the Company in accordance with IFRS. Company law requires the Directors to prepare such financial statements in accordance with International Financial Reporting Standards, the Companies Act 2006 and Article 4 of the IAS Regulation.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's Framework for the Preparation and Presentation of Financial Statements. In virtually all circumstances, a fair presentation will be achieved by compliance with all International Financial Reporting Standards.

Directors are also required to

- select applicable accounting policies and apply them properly
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance
- prepare the accounts on a going concern basis unless, having assessed the ability of the Company to continue as a going concern, management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and Group, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of the Directors' report and the Directors' remuneration report which comply with the requirements of the Companies Act 2006.

The Directors are responsible for the maintenance and integrity of the Company website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

On behalf of the Board of Network Rail

Hazel Walker
Group Company Secretary
8 June 2011

Independent auditors' report

to the Members of Network Rail Infrastructure Limited

We have audited the Group and parent company financial statements (the 'financial statements') of Network Rail Infrastructure Limited for the year ended 31 March 2011 which comprise the Group Income statement, the Group and parent Company Statements of comprehensive income, the Group and parent Company Balance sheets, the Group and parent Company Statements of cash flows, the Group Statement of changes in equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of Directors and auditors

As explained more fully in the Directors' responsibilities statement on page 75, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's Members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 March 2011 and of the Group's profit and Group's and parent Company's cash flows for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent Company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

The Directors have requested, (because the Company applies Listing Rules 9.8.6R 3, 5 and 6 of the Financial Services Authority as if it were a listed company), that we review the parts of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review by the Listing Rules of the Financial Services Authority and that we review the Directors' statement, set out on pages 15-27, in relation to going concern. We have nothing to report in respect of these reviews.

Other matter

At the request of the Directors, we have also audited the part of the Directors' Remuneration Report that is described as having been audited. In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Jonathan Hook (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors

London
8 June 2011

Income statement

for the year ended 31 March 2011

	Notes	Results pre debt and derivative revaluations 2011 Group £m	Debt and derivative revaluations (Note 8) 2011 Group £m	2011 Group £m	2010 Group £m
Revenue	3	**5,712**	**–**	**5,712**	5,668
Net operating costs	4	**(3,684)**	**–**	**(3,684)**	(3,687)
Operating profit		**2,028**	**–**	**2,028**	1,981
Property revaluation movements and profits on disposal		**11**	**–**	**11**	62
Total profits from operations	5	**2,039**	**–**	**2,039**	2,043
Investment revenue	7	**83**	**–**	**83**	26
Other gains and losses	8	**–**	**(183)**	**(183)**	(477)
Finance costs	9	**(1,501)**	**–**	**(1,501)**	(1,197)
Profit before tax		**621**	**(183)**	**438**	395
Tax	10	**(176)**	**51**	**(125)**	(111)
Profit for the year attributable to equity shareholder		**445**	**(132)**	**313**	284

All amounts in the current and prior years relate to continuing operations.

Under section 408 of the Companies Act 2006 the Group has elected to take the exemption with regard to disclosing the Company Income statement. The Company's net profit for the year was £352m (2010: £274m).

Statements of comprehensive income

for the year ended 31 March 2011

	2011 Group £m	2010 Group £m	2011 Company £m	2010 Company £m
Profit for the year	**313**	284	**352**	274
Gains/(losses) on revaluation of the railway network	**222**	(1,033)	**222**	(1,033)
(Losses)/gains on movement in fair value of hedging derivatives	**(251)**	(179)	**43**	(37)
Recycling of balances in hedging reserve to the income statement	**5**	4	**5**	4
Exchange differences on cash flow hedges recycled from the hedging reserve	**360**	154	**–**	–
	114	(21)	**48**	(33)
Actuarial gains/(losses) on defined benefit pension schemes	**545**	(292)	**545**	(292)
Tax relating to components of other comprehensive income	**(60)**	376	**(126)**	380
Other comprehensive income/(loss) for the year	**821**	(970)	**689**	(978)
Total comprehensive income/(loss) for the year attributable to equity shareholder	**1,134**	(686)	**1,041**	(704)

Statements of changes in equity

for the year ended 31 March 2011

Group	Share capital £m	Share Premium £m	Revaluation Reserve £m	Other Reserve* £m	Hedging Reserve £m	Retained Earnings £m	Total £m
Balance at 1 April 2009	**160**	**85**	**4,298**	**1,458**	**(318)**	**1,558**	**7,241**
Profit for the year	–	–	–	–	–	284	284
Other comprehensive income							
Revaluation of the railway network	–	–	(1,033)	–	–	–	(1,033)
Transfer of deemed cost depreciation from revaluation reserve	–	–	(147)	–	–	147	–
(Increase)/decrease in deferred tax liability on the railway network	–	–	330	–	–	(41)	289
Actuarial losses on defined benefit pension schemes	–	–	–	–	–	(292)	(292)
Deferred tax on actuarial losses	–	–	–	–	–	82	82
Decrease in fair value of hedging derivatives	–	–	–	–	(179)	–	(179)
Exchange differences on cash flow hedges recycled from the hedging reserve	–	–	–	–	154	–	154
Deferred tax on all hedging reserve movements/retained earnings	–	–	–	–	5	–	5
Recycling of balances in hedging reserve to the income statement	–	–	–	–	4	–	4
Total comprehensive (loss)/income	**–**	**–**	**(850)**	**–**	**(16)**	**180**	**(686)**
Balance at 31 March 2010	**160**	**85**	**3,448**	**1,458**	**(334)**	**1,738**	**6,555**
Profit for the year	–	–	–	–	–	313	313
Other comprehensive income							
Impact of change in tax rate	–	–	103	–	(10)	(18)	75
Revaluation of the railway network	–	–	222	–	–		222
Transfer of deemed cost depreciation from revaluation reserve	–	–	(158)	–	–	158	–
Increase in deferred tax liability on the railway network	–	–	(17)	–	–	(41)	(58)
Actuarial gains on defined benefit pension schemes	–	–	–	–	–	545	545
Deferred tax on actuarial gains	–	–	–	–	–	(142)	(142)
Decrease in fair value of hedging derivatives	–	–	–	–	(251)	–	(251)
Exchange differences on cash flow hedges recycled from the hedging reserve	–	–	–	–	360	–	360
Deferred tax on all hedging reserve movements/retained earnings	–	–	–	–	65	–	65
Recycling of balances in hedging reserve to the income statement	–	–	–	–	5	–	5
Total comprehensive income	**–**	**–**	**150**	**–**	**169**	**815**	**1,134**
Balance at 31 March 2011	**160**	**85**	**3,598**	**1,458**	**(165)**	**2,553**	**7,689**

* Other reserves of £1,458m (2010: £1,458m) include the vesting reserve on privatisation.

Statements of changes in equity

for the year ended 31 March 2011

Company	Share capital £m	Share Premium £m	Revaluation Reserve £m	Other Reserve* £m	Hedging Reserve £m	Retained Earnings £m	Total £m
Balance at 1 April 2009	**160**	**85**	**4,298**	**1,458**	**(260)**	**1,529**	**7,270**
Profit for the year	–	–	–	–	–	274	274
Other comprehensive income							
Revaluation of the railway network	–	–	(1,033)	–	–	–	(1,033)
Transfer of deemed cost depreciation from revaluation reserve	–	–	(147)	–	–	147	–
(Increase)/decrease in deferred tax liability on the railway network	–	–	330	–	–	(41)	289
Actuarial losses on defined benefit pension schemes	–	–	–	–	–	(292)	(292)
Deferred tax on actuarial losses	–	–	–	–	–	82	82
Decrease in fair value of hedging derivatives	–	–	–	–	(37)	–	(37)
Deferred tax on all hedging reserve movements/retained earnings	–	–	–	–	9	–	9
Recycling of balances in hedging reserve to the income statement	–	–	–	–	4	–	4
Total comprehensive (loss)/income	**–**	**–**	**(850)**	**–**	**(24)**	**170**	**(704)**
Balance at 31 March 2010	**160**	**85**	**3,448**	**1,458**	**(284)**	**1,699**	**6,566**
Profit for the year	–	–	–	–	–	352	352
Other comprehensive income							
Impact of change in tax rate	–	–	103	–	–	(18)	85
Revaluation of the railway network	–	–	222	–	–	–	222
Transfer of deemed cost depreciation from revaluation reserve	–	–	(158)	–	–	158	–
Increase in deferred tax liability on the railway network	–	–	(17)	–	–	(41)	(58)
Actuarial gains on defined benefit pension schemes	–	–	–	–	–	545	545
Deferred tax on actuarial gains	–	–	–	–	–	(142)	(142)
Increase in fair value of hedging derivatives	–	–	–	–	43	–	43
Deferred tax on all hedging reserve movements/retained earnings	–	–	–	–	(11)	–	(11)
Recycling of balances in hedging reserve to the income statement	–	–	–	–	5	–	5
Total comprehensive income	**–**	**–**	**150**	**–**	**37**	**854**	**1,041**
Balance at 31 March 2011	**160**	**85**	**3,598**	**1,458**	**(247)**	**2,553**	**7,607**

* Other reserves of £1,458m (2010: £1,458m) include the vesting reserve on privatisation.

Balance sheets

at 31 March 2011

	Notes	2011 Group £m	2010 Group £m	2011 Company £m	2010 Company £m
Assets					
Non-current assets					
Intangible assets	11	**71**	72	**–**	–
Property, plant and equipment – the railway network	12	**39,577**	36,629	**39,577**	36,629
Investment property	13	**778**	764	**778**	764
Investment in subsidiaries	14	**–**	–	**148**	49
Loan to immediate parent company	17	**397**	391	**397**	391
Loan to other Group company	17	**–**	–	**–**	104
Derivative financial instruments	20	**576**	702	**–**	–
Finance lease receivables	16	**6**	8	**6**	8
Interest in joint venture	14	**5**	5	**5**	5
Total non-current financial assets		**984**	1,106	**408**	508
		41,410	38,571	**40,911**	37,950
Current assets					
Inventories	15	**108**	132	**108**	132
Finance lease receivables	16	**1**	2	**1**	2
Trade and other receivables	17	**905**	720	**900**	781
Current tax assets		**–**	6	**–**	–
Derivative financial instruments	20	**104**	297	**–**	1
Cash and cash equivalents		**771**	2,321	**–**	80
		1,889	3,478	**1,009**	996
Total assets		**43,299**	42,049	**41,920**	38,946
Current liabilities					
Trade and other payables	18	**(2,823)**	(3,043)	**(2,695)**	(2,678)
Current tax liabilities		**(7)**	–	**(8)**	(8)
Bank loans and overdrafts	19	**(2,314)**	(2,223)	**(1,782)**	(241)
Derivative financial instruments	20	**(373)**	(210)	**(234)**	(121)
Short-term provisions	21	**(17)**	(57)	**(17)**	(57)
		(5,534)	(5,533)	**(4,736)**	(3,105)
Net current liabilities		**(3,645)**	(2,055)	**(3,727)**	(2,109)
Non-current liabilities					
Bank loans	19	**(23,345)**	(23,380)	**(22,891)**	(22,718)
Derivative financial instruments	20	**(574)**	(507)	**(505)**	(500)
Other payables	18	**(2,293)**	(1,887)	**(2,293)**	(1,887)
Retirement benefit obligation	29	**(485)**	(985)	**(485)**	(985)
Deferred tax liabilities	22	**(3,377)**	(3,200)	**(3,401)**	(3,183)
Obligations under finance leases	23	**(2)**	(2)	**(2)**	(2)
		(30,076)	(29,961)	**(29,577)**	(29,275)
Total liabilities		**(35,610)**	(35,494)	**(34,313)**	(32,380)
Net assets		**7,689**	6,555	**7,607**	6,566
Equity					
Share capital	24	**160**	160	**160**	160
Share premium account		**85**	85	**85**	85
Revaluation reserve		**3,598**	3,448	**3,598**	3,448
Other reserve		**1,458**	1,458	**1,458**	1,458
Hedging reserve		**(165)**	(334)	**(247)**	(284)
Retained earnings		**2,553**	1,738	**2,553**	1,699
Total shareholder's funds and equity attributable to equity holders of the parent company		**7,689**	6,555	**7,607**	6,566

The financial statements were approved by the Board of Directors and authorised for issue on 8 June 2011.

They were signed on its behalf by:

David Higgins Director

Patrick Butcher Director

Company reference number: 2904587

Statements of cash flows

for the year ended 31 March 2011

	Notes	2011 Group £m	2010 Group £m	2011 Company £m	2010 Company £m
Net cash generated from operating activities	25	**2,486**	2,234	**2,442**	2,370
Investing activities					
Interest received		**77**	24	**68**	13
Purchases of property, plant and equipment – the railway network		**(3,759)**	(3,939)	**(3,759)**	(3,939)
Proceeds on disposal of investment property		**12**	1	**12**	1
Capital grants received		**186**	339	**186**	339
Capital element of finance leases' receipts		**2**	2	**2**	2
Purchase of shares in subsidiary		**–**	–	**(99)**	–
Net cash used in investing activities		**(3,482)**	(3,573)	**(3,590)**	(3,584)
Financing activities					
Repayments of borrowings		**(1,926)**	(1,416)	**(1,926)**	(1,416)
New loans raised		**1,782**	4,053	**3,009**	2,902
Collateral repaid to counterparties		**(395)**	(508)	**–**	–
Losses on derivatives not hedge accounted		**(15)**	(192)	**(15)**	(192)
Net cash (consumed by)/generated from financing activities		**(554)**	1,937	**1,068**	1,294
Net (decrease)/increase in cash and cash equivalents		**(1,550)**	598	**(80)**	80
Cash and cash equivalents at beginning of the year		**2,321**	1,723	**80**	–
Cash and cash equivalents at end of the year		**771**	2,321	**–**	80

Notes to the financial statements

for the year ended 31 March 2011

1. General information

Network Rail Infrastructure Limited is a company incorporated in Great Britain and registered in England and Wales under the Companies Act 2006.

The Company registration number is 2904587.

The Company's registered office is situated at Kings Place, 90 York Way, London N1 9AG.

The Company's principal activities are detailed in the Directors' report on pages 15 to 27.

The Company's parent is Network Rail Holdco Limited, a company incorporated in Great Britain and registered in England and Wales. The Company's ultimate parent company is Network Rail Limited, a company limited by guarantee incorporated in Great Britain and registered in England and Wales.

Presentation of the Income statement: exceptional debt and derivative revaluations

The Income statement has been presented in a three-column format in order to allow users to appreciate the impact on the results for the year of gains and losses arising from the revaluation of debt and derivatives. See Note 8 for further information.

2. Significant accounting policies

Basis of accounting

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted for use in the European Union, and therefore comply with Article 4 of the European Union International Accounting Standard regulation.

The financial statements have been prepared on the historical cost basis, except for the revaluation of the railway network to a value determined using an income approach, the revaluation of investment properties, the measurement of certain financial assets and liabilities at fair value through profit and loss (FVTPL), and the measurement of derivative financial instruments at fair value.

The principal accounting policies adopted by the Directors are set out below.

Adoption of new and revised standards

The following new and revised Standards and Interpretations have been adopted in these financial statements. Their adoption has not had any significant impact on the amounts reported in these financial statements but may affect the accounting for future transactions or arrangements.

IFRS 3 (revised)	*Business Combinations*
Amendment to IFRS 1	*First-time Adoption of IFRS*
Revised IFRS 1	*First-time Adoption of IFRS*
Amendments to IFRS 2	*Share-based Payments*
IAS 27 (revised)	*Consolidated and Individual Financial Statements*
Amendment to IAS 32	*Classification of Rights Issues*
Amendment to IAS 39	*Financial Instruments: Recognition and Measurement* (eligible hedged items)
IFRIC 17	*Distribution of Non-cash Assets to Owners*
IFRIC 18	*Transfers of Assets from Customers*
Improvements to IFRS 2009	

At the date of authorisation of these financial statements, the following Standards and Interpretations, which have not been applied in these financial statements, were in issue but not yet effective (and in some cases had not been adopted by the EU):

IFRS 9	*Financial Instruments*
Revised IAS 24	*Related Party Transactions*
IFRIC 19	*Extinguishing Financial Liabilities with Equity Instruments*
Amendments to IFRIC 14	*Prepayments of a Minimum Funding Requirement*
Amendments to IFRS 1	*First-time Adoption of IFRS* (comparative IFRS 7 disclosures)
Amendments to IFRS 7	*Financial Instruments: Disclosures (*disclosures for transfers of financial assets)
Amendments to IAS 12	*Deferred Tax*
Improvements to IFRS 2010	

The Directors anticipate that the adoption of these Standards and Interpretations in the future will have no material effect on the financial statements of the Group.

2. Significant accounting policies continued

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Directors' report on pages 15 to 27. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Group Finance Director's review on pages 8 to 14. In addition, Note 28 to the accounts includes the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit, liquidity and foreign exchange risk.

The Group has considerable financial resources together with long-term contracts with a number of customers and suppliers. As a consequence, the Directors believe that the Group is well placed to manage its business risks.

After making enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company. This includes special purpose financing companies which are not members of the Network Rail Group but are treated as subsidiaries in the consolidated accounts of Network Rail Infrastructure Limited. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Revenue represents amounts derived from the management and provision of assets for the use in the operation of the railway and property rental income net of value added tax. Amounts recognised take account of any performance penalties or bonuses in respect of the year.

Revenue also includes supplements to the access charges and bonuses receivable from, less penalties payable to, customers. Operating expenditure includes additional contract amounts and bonuses payable to, less penalties receivable from, suppliers and the Office of Rail Regulation.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable. This is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Grants

Grants and other contributions received towards the cost of property, plant and equipment are included in trade and other payables as deferred income and released to the Income statement over the estimated useful economic life of the railway network. Revenue grants earned for the management and provision of railway network assets are credited to the Income statement in the period to which they relate.

Leasing

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessor

Amounts due from lessees under finance leases are recorded as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment outstanding in respect of the leases.

Rental income from operating leases and initial direct costs are recognised on a straight-line basis over the term of the relevant lease.

The Group as lessee

Assets held under finance leases are recognised at their fair value as assets of the Group or, if lower, at the present value of the minimum lease payments. Each is determined at the inception of the lease. The corresponding liability to the lessor is included in the Balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to the Income statement, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the Group's general policy on borrowing costs (see below).

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

Foreign currencies

Monetary assets and liabilities expressed in foreign currencies are translated into sterling at rates of exchange prevailing at the Balance sheet date. Foreign currency amounts are initially recorded at the rates of exchange prevailing on the dates of the transactions. Individual transactions denominated in foreign currencies are translated into sterling at the exchange rates prevailing on the dates payment takes place. Gains and losses arising on retranslation are included in the Income statement for the period and are classified as either operating or financing depending on the nature of the monetary item giving rise to them.

2. Significant accounting policies continued

Borrowing costs

Borrowing costs directly attributable to the construction of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use.

All other borrowing costs are recognised in the Income statement in the period in which they are incurred.

Operating profit

Operating profit is stated before investment income, finance costs, other gains and losses, and revaluation movements and profits on disposal of properties. A middle column has been presented to allow users to appreciate the impact of the revaluation of debt and derivatives on the results for the year. Not all hedging strategies qualify for hedge accounting and the Directors believe that by separating gains and losses arising from applying the valuation requirements of IAS 39, the users of this financial information will better understand the underlying performance of the Group.

Retirement benefit costs

Payments to the defined contribution retirement benefit scheme are charged as an expense as they fall due.

For the defined benefit scheme, the cost of providing benefits is determined using the Projected Unit Credit Method, with full actuarial valuations being carried out at least every three years and updates to these valuations carried out in intervening years.

The Group's share of the actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the Income statement and presented in the Statement of comprehensive income.

Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefits become vested.

The retirement benefit obligation recognised in the Balance sheet represents the present value of the defined benefit obligation, as adjusted for unrecognised past service cost, and as reduced by the fair value of scheme assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds and reductions in future contributions to the plan.

Tax

The tax expense represents the sum of the current tax payable and deferred tax. The Group's current tax liability is calculated using the tax rates that have been enacted or substantively enacted by the Balance sheet date.

Current taxes are based on the taxable results of the Group and calculated in accordance with tax rules in the United Kingdom.

Deferred tax is the tax expected to be payable or recoverable on the temporary differences that arise when tax authorities recognise and measure assets and liabilities with rules that differ from those of the consolidated accounts. Deferred taxes are calculated under the Balance sheet liability method at the rate of tax expected to prevail, subject to the rate being enacted or substantively enacted by that date, when the temporary differences reverse. Deferred tax is not discounted.

Deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised on all deductible temporary differences to the extent that it is probable that there will be taxable profits available against which the temporary timing differences can be utilised.

Deferred tax assets and liabilities are not recognised if the temporary differences arise from the initial recognition of goodwill, non-deductible goodwill or from initial recognition (other than a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit or loss nor the accounting profit or loss.

Deferred tax is charged or credited in the income statement except when it relates to items charged or credited directly to equity. In this case the deferred tax is also dealt with in equity.

Property, plant and equipment – the railway network

The Company has one class of property, plant and equipment, being the railway network. This is the integrated network that the Company uses to deliver the operation, maintenance and renewal of Great Britain's national rail infrastructure, and constitutes one class of asset.

Valuation methodology

The railway network is carried in the Balance sheet at its fair value. Because there is no active market in railway infrastructure assets, the Company has derived the fair value of the railway network using an income approach. The income approach assesses the discounted future cash flows that are expected to be generated by the railway network. This valuation is carried out annually and revaluation gains and losses are reflected in other comprehensive income.

Depreciation

The railway network is depreciated on a straight-line basis over its estimated remaining weighted average useful economic life. The estimated remaining weighted average useful economic life of the network is currently 30 years (2010: 30 years). The remaining useful economic lives of network assets are estimated annually, with external verification of the valuation and asset lives carried out where required.

2. Significant accounting policies continued

Investment property
Investment property, which is property held to earn rentals and/or for capital appreciation, is stated at its fair value at the Balance sheet date. Gains and losses from changes in the fair value of investment property are included in the Income statement for the period in which they arise.

Research and development
Research and general development expenditure is charged to the Income statement as incurred. Expenditure on the development of specific projects is capitalised only if all of the following conditions are met:

- an asset is created that can be identified
- it is probable that the asset created will generate future economic benefits
- the development cost of the asset can be measured reliably.

Intangible fixed assets
An intangible asset is only recognised if it is probable that future economic benefits will flow to the Group and its costs can be measured reliably. Intangible fixed assets are measured initially at purchase cost and are amortised on a straight-line basis. Licences are amortised over the length of their contractual agreement. Intangible fixed assets are tested for impairment at each Balance sheet date by comparing their carrying value and the expected discounted cash flows expected to arise from them over their contractual agreements. If the carrying value exceeds the discounted cash flows expected to arise from the assets, the carrying value would be impaired accordingly.

Inventories
Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method.

Financial instruments
Financial assets and financial liabilities are recognised on the Group's Balance sheet when the Group becomes party to the contractual provisions of the instrument.

Financial assets
Financial assets are recognised on a trade date where a purchase or sale of an investment is under contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, plus transaction costs, except for those investments classified as at fair value through profit or loss, which are initially measured at fair value.

Financial assets are classified as financial assets 'at fair value through profit or loss' (FVTPL), 'available-for-sale' financial assets, and 'trade and other receivables'. Trade receivables do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts, recognised in the Income statement. The remaining assets are measured at subsequent reporting dates at fair value.

Financial assets at FVTPL
Financial assets are classified as at fair value through profit or loss (FVTPL) where the asset is either held for trading or it is designated at FVTPL. Gains and losses arising from changes in fair value of these assets are recognised in the Income statement for the period. A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling in the near future; or
- it is a derivative that is not designated and effective as a hedging instrument.

Available-for-sale financial assets
Gains and losses from changes in fair value of these assets are recognised directly in equity until the security is disposed of or is determined to be impaired. At this point the cumulative gain or loss previously recognised in equity is included in the Income statement for the period.

Impairment of financial assets
Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each Balance sheet date. Financial assets at FVTPL are stated at fair value with any resultant gain or loss recognised in the Income statement. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

The carrying amount of the financial asset directly reduced by the impairment loss for all financial assets with the exception of trade receivables, which are reduced by appropriate allowances for irrecoverable amounts. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the Income statement. The reversal is only made to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Cash and cash equivalents
Cash and cash equivalents comprise bank balances held by the Group and money market deposit investments all denominated in sterling at varying rates. The carrying amount of these assets approximates their fair value.

2. Significant accounting policies continued

Joint ventures

The results and assets and liabilities of joint ventures are incorporated in these financial statements using the equity method of accounting. Investments in joint ventures are carried in the Balance sheet at cost as adjusted by post-acquisition changes in the Group's share of net assets of joint ventures, less any impairment in the value of individual investments. Losses of a joint venture in excess of the Group's interest in a joint venture are not recognised.

Financial liabilities

Financial liabilities are classified according to the substance of the contractual arrangements entered into.

Financial liabilities at FVTPL

Financial liabilities are classified as at FVTPL where the financial liability is either held for trading or it is designated at FVTPL. A financial liability is classified as held for trading if it is a derivative that is not designated and effective as a hedging instrument.

A financial liability other than a financial liability held for trading is designated as at FVTPL upon initial recognition if such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise exist, in line with International Accounting Standard 39 *Financial Instruments: Recognition and Measurement*, paragraph 9(b)(i). Certain bonds, as set out in Note 19, are designated at FVTPL. These bonds are hedged by derivative financial instruments as part of a documented risk management strategy. By recognising these bonds and derivatives at FVTPL the recognition inconsistencies that would otherwise exist with regard to these risk management strategies are significantly reduced.

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or expire.

Debt

Debt instruments not designated at FVTPL are initially measured at fair value, net of discount and direct issue costs, and subsequently recognised at amortised cost. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an accrual basis to the Income statement using the effective interest rate method, and are added to the carrying value of the debt instrument to the extent that they are not settled in the period in which they arise.

Trade payables

Trade payables are ordinarily not interest bearing and are stated at cost.

Derivative financial instruments and hedge accounting

The Group's activities expose it primarily to the financial risks of changes in interest rates and foreign currency exchange rates. The Group uses interest rate swaps, cross-currency swaps and foreign exchange forward contracts to hedge these exposures. The use of financial derivatives is governed by the Group's policies approved by the Treasury Committee of the Board, which provide written principles on the use of financial derivatives.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each Balance sheet date.

The Group designates certain hedging instruments as either cash flow hedges or fair value hedges. At the inception of the hedge relationship, the entity documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Group documents whether the hedging instrument that is used in a hedging relationship is highly effective in offsetting changes in fair values or cash flows of the hedged item.

Some derivatives, while complying with the Group's financial risk management policies, do not qualify for hedge accounting and are therefore classified as held for trading. Changes in the fair value of derivative financial instruments that do not qualify for cash flow hedge accounting are recognised in the Income statement as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. At that time, the net cumulative gain or loss recognised in equity is recycled to the Income statement in the year.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not carried at fair value, with gains or losses being reported in the Income statement.

Note 20 sets out details of the fair values of the derivative instruments used for hedging purposes. Movements in the hedging reserve in equity are detailed in the Statements of changes in equity and in the Statements of comprehensive income.

Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income statement, together with any changes in the fair value of the hedged item that is attributed to the hedged risk. The change in the fair value of the hedging instrument and the change in the hedged item attributable to the hedged risk are recognised within 'Other gains and losses' in the Income statement.

2. Significant accounting policies continued

Cash flow hedges

Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised in other comprehensive income, and the ineffective portion is recognised immediately within 'Other gains and losses' in the Income statement.

Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the Balance sheet date, and are discounted to present value where the effect is material.

Critical accounting judgements and key sources of uncertainty

(i) Property, plant and equipment – the railway network: the estimate of the fair value of the railway network is based on an income approach using the regulatory asset base, which equates to the discounted future cash flow associated with the network, adjusted for the net present value of any variances from the Office of Rail Regulation's determination included in the Group's Business Plan. Further details are set out in Note 12.

(ii) Investment property – the investment property portfolio valuation is determined using the Beacon method. King Sturge provided their assessment of yields for 12 properties in the portfolio. These are then used to produce income multipliers and applied to the rental streams from each of the individual properties in the portfolio to form an overall valuation. Further details are set out in Note 13.

(iii) Retirement benefit obligations – the Group recognises and discloses its retirement benefit obligation in accordance with the measurement and presentational requirement of IAS 19 'Employee Benefits'. The calculations include a number of judgements and estimations in respect of the expected rate of return on assets, the discount rate, inflation assumptions, the rate of increase in salaries and life expectancy amongst others. Changes in these assumptions can have a significant effect on the value of the retirement benefit obligation. The key assumptions made are set out in Note 29. The total contribution rate payable under the Railway Pension Scheme (RPS) and the Career Average Revalued Earnings (CARE) scheme is normally split in the proportion 60:40 between the Group and the members, respectively. The Group reflects its share of the contribution in the financial statements.

(iv) Provisions – provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the Balance sheet date, and are discounted to present value where the effect is material.

3. Revenue

	2011 Group £m	2010 Group £m
Franchised track access and grant income	**5,408**	5,387
Freight revenue	**43**	52
Property rental income	**244**	206
Other income	**17**	23
Revenue for the year	**5,712**	5,668

The net effect of the performance regimes on the results of the Group and Company was a net loss of £14m (2010: net income of £42m).

4. Net operating costs

	2011 Group £m	2010 Group £m
Employee costs (see Note 6)	**1,734**	1,746
Own costs capitalised	**(623)**	(680)
Other external charges (including infrastructure maintenance costs)	**1,601**	1,730
Other operating income	**(245)**	(250)
Net operating costs before depreciation	**2,467**	2,546
Depreciation and other amounts written off non-current assets	**1,271**	1,193
Capital grants amortised	**(54)**	(52)
Net operating costs	**3,684**	3,687

5. Profit from operations

Profit from operations is stated after charging/(crediting):

	2011 Group £m	2010 Group £m
Research and development costs expensed	**1**	1
Depreciation and other amounts written off property, plant and equipment	**1,271**	1,193
Amortisation of intangible fixed assets	**1**	1
Amortisation of capital grants	**(54)**	(52)
Profit on sale of properties	**(12)**	–
Decrease/(increase) in the fair value of investment properties	**1**	(62)
Cost of inventories recognised as an expense	**176**	179
Write downs of inventories recognised as an expense	**10**	7
Employee costs (see Note 6)	**1,734**	1,746
Amounts payable to auditors		
Fees payable to the Company's auditors for the audit of the Company's annual accounts	**0.27**	0.35
Fees payable to the Company's auditors for other services to the Group		
– The audit of the Company's subsidiaries pursuant to legislation	**0.03**	0.04
Total audit fees	**0.30**	0.39
Other services pursuant to legislation		
– Regulatory accounts audit and interim review	**0.08**	0.12
– Other	**0.02**	0.02
Total non-audit fees	**0.10**	0.14
Total amounts payable to auditors	**0.40**	0.53

6. Employee costs

The average number of employees (including Executive Directors) was:

	2011 Group and Company Number	2010 Group and Company Number
Management and operation of the railway	**35,606**	37,153

	2011 Group and Company £m	2010 Group and Company £m
Their aggregate remuneration comprised:		
Wages and salaries	**1,465**	1,504
Social security costs	**121**	127
Defined contribution pension costs (see Note 29)	**17**	16
Defined benefit pension costs – current service costs (see Note 29)	**131**	99
	1,734	1,746

7. Investment revenue

	2011 Group £m	2010 Group £m
Interest receivable from immediate parent company	**9**	11
Interest receivable on investments and deposits	**73**	14
Interest receivable on finance leases	**1**	1
	83	26

Investment revenue earned on financial assets analysed by category of asset, is as follows:

	2011 Group £m	2010 Group £m
Loans and receivables (including cash and bank balances)	**83**	26
	83	26

8. Other gains and losses

	2011 Group £m	2010 Group £m
Net ineffectiveness arising from cash flow hedge accounting	**(44)**	(72)
Net decrease in fair value of fair value hedges	**(127)**	(213)
Net increase in carrying value of fair value hedged debt	**117**	209
Losses arising from fair value hedge accounting	**(10)**	(4)
Net increase in fair value of non-hedge accounted debt	**(20)**	(8)
Net decrease in fair value of derivatives not hedge accounted	**(94)**	(201)
Realised losses arising from derivatives not hedge accounted	**(15)**	(192)
Losses arising from non-hedge accounting	**(129)**	(401)
Total other losses	**(183)**	(477)

No other gains and losses have been recognised in respect of loans and receivables other than those disclosed in this note. No gains or losses have been recognised on financial liabilities measured at amortised cost other than those disclosed in Note 9.

The gain/loss arising on adjustment for the hedged item in a designated fair value hedge accounting relationship, the change in fair value of debt designated as fair value through profit and loss, and the exchange differences on retranslation of foreign currency debt form part of the net gains/losses on other financial liabilities carried at amortised cost and relate to debt issuances disclosed in Note 19.

The overall size of the debt and derivative movements will be significantly affected by the real interest rate hedging activities with regard to future index-linked debt issuance. Hedge accounting under IAS 39 has not been applied to this hedge of the real interest rate.

Debt and derivative revaluations

The Income statement has been presented in a three-column format in order to allow users to appreciate the impact of the revaluation of debt and derivatives on the results for the year. Not all hedging strategies qualify for hedge accounting and the Directors believe that by separating gains and losses arising from applying the valuation requirements of IAS 39, the users of this financial information will better understand the underlying performance of the Group.

Those items that have been identified for disclosure as changes in debt and derivative valuations are explained above.

9. Finance costs

	2011 Group £m	2010 Group £m
Interest on bank loans and overdrafts	**56**	54
Interest on bonds issued under the Debt Issuance Programme	**1,349**	1,011
Expected return on assets less interest on liabilities in respect of defined benefit pension schemes	**27**	40
Other interest	**186**	187
Total borrowing costs	**1,618**	1,292
Less: capitalised interest	**(117)**	(95)
Total finance costs	**1,501**	1,197

Borrowing costs are included in the costs of qualifying assets to the extent that the asset is financed by the Group. The average rate used during the year was 5.8 per cent (2010: 5.9 per cent).

10. Tax

	2011 Group £m	2010 Group £m
Current tax:		
UK Corporation tax at 28% (2010: 28%):		
Corporation tax charge	**(19)**	(1)
Less advance corporation tax (ACT) set-off	**13**	–
Corporation tax liability	**(6)**	(1)
Prior year (charge)/credit	**4**	8
Group relief payable to Network Rail Holdco Limited	**(6)**	(3)
Total current tax	**(8)**	4
Deferred tax:		
Deferred tax at 26% (2010: 28%)		
Current year (charge)/credit	**(131)**	(120)
Effect of rate (charge)/credit	**163**	–
Prior year (charge)/credit	**(149)**	5
Total deferred tax	**(117)**	(115)
Total tax	**(125)**	(111)

The tax charge for the year can be reconciled to the profit per the Income statement as follows:

	2011 Group £m	2010 Group £m
Profit before tax	**438**	395
Tax at the UK corporation tax rate of 28% (2010: 28%)	**123**	111
Adjustments in respect of prior years	**143**	(13)
Rate changes	**(163)**	–
Permanent differences	**35**	13
Advance corporation tax previously written off	**(13)**	–
Tax charge for the year	**125**	111

In addition to the amounts charged to the Income statement, deferred tax relating to the revaluation of the railway network amounting to a credit of £45m including the impact of the rate change (2010: £289m) has been charged directly to equity. Movements on the hedging reserve amounted to £55m credit including the impact of the rate change (2010: £7m credit). Movements relating to retirement benefit obligations amounted to a £160m charge to equity including the impact of the rate change (2010: £82m credit). The adjustment in respect of prior years relates to reassessments of provisions for deductions in capital allowances.

Deferred tax is calculated at a rate of 26 per cent (2010: 28 per cent). 26 per cent (2010: 28 per cent) is also used for the reconciliation above as the tax charge is substantively deferred tax.

UK corporation tax is calculated at 28 per cent (2010: 28 per cent).

The Company and the Group have £29m (2010: £39m) of surplus ACT carried forward (including a release in relation to the prior period). No deferred tax asset has been provided in respect of this amount.

11. Intangible assets

Group	Concessions £m
Cost	
At 1 April 2009, 1 April 2010 and 31 March 2011	**78**
Amortisation	
At 1 April 2009	(5)
Charge for the year	(1)
At 1 April 2010	**(6)**
Charge for the year	(1)
At 31 March 2011	**(7)**
Carrying amount	**71**
At 31 March 2011	**71**
At 31 March 2010	72

The intangible assets above are held by the Company's wholly owned subsidiary Network Rail (CTRL) Limited.

The concession to run the operations, maintenance and renewal business of the Channel Tunnel Rail Link is being amortised over 84 years, to 2086.

12. Property, plant and equipment – the railway network

	Group and Company £m
Valuation	
At 1 April 2009	34,925
Additions	3,920
Depreciation charge for the year	(1,193)
Transfers from investment property	10
Revaluation in the year	(1,033)
At 1 April 2010	**36,629**
Additions	3,997
Depreciation charge for the year	(1,271)
Revaluation in the year	222
At 31 March 2011	**39,577**

Given the interdependency of the assets comprising the railway network, the Company has concluded that the railway network is a single class of asset. The railway network is carried at its fair value, which is measured as the estimated future cash flows that are expected to be generated in perpetuity, discounted at the Company's pre-tax rate of return, as set by the independent rail regulator, the Office of Rail Regulation (the ORR), in its Access Charges Review. This rate reflects the risks and opportunities that exist in the regulated market for railway infrastructure assets and equates to the cost of capital for this market.

The RAB is a proxy for the present value of future cash flows

Because there is no active market in railway infrastructure assets, the Company has derived the fair value of the railway network using an income approach. The income approach assesses the discounted future cash flows that are generated by the railway network. This valuation is carried out annually and revaluation gains and losses are reflected in other comprehensive income.

The income approach to determining the fair value of the railway network involves using the regulatory asset base (RAB), which is a proxy for a discounted cash flow calculation, adjusted for forecast performance variations.

The RAB is used by the ORR to set Network Rail's charges to customers and is a proxy for the present value of future cash flows. Annual income (receivable as track access charges and the network grant) comprises three elements:

a) Efficient operating and maintenance costs – paid to Network Rail as they are expected to be incurred

b) RAB amortisation – capital expenditure is added to the RAB as incurred in order to spread the cost to customers and stakeholders of investment in the railway network over many years. The ORR allows Network Rail to recover these costs through amortisation of the RAB

c) Allowed return – calculated by applying the rate of return permitted by the ORR (based on its assessment of the market's cost of capital) to the RAB balance. If this rate of return changes, then this element of the Company's income changes, but the RAB does not change.

The RAB is a proxy for the present value of the future cash flows because the net cash flow that the Company is allowed to earn is the RAB multiplied by the rate of return allowed by the regulator, which reflects the risks and opportunities that exist in the regulated market for railway infrastructure assets. This rate equates to the market's pre-tax cost of capital.

12. Property, plant and equipment – the railway network continued

Discount rate

The discount rate used in the income approach is the pre-tax rate of return set by the ORR. The ORR performs a periodic review every five years, which leads to the setting of the appropriate rate for the five-year period. The ORR's method encompasses advice from consultants, comparisons to similar infrastructure assets and discussions with Network Rail. The rate of return set by the ORR reflects the risks and opportunities that exist in the regulated market for railway infrastructure assets and equates to the cost of capital for this market.

The Company's annual revaluation includes an assessment of the discount rate set by the ORR to determine whether it continues to reflect current conditions in the market. Should this assessment show that the market cost of capital is materially different to the rate set by the ORR, this will be reflected in the valuation.

The permitted rate of return was determined by the ORR, for the five years to April 2014, to be 4.75 per cent. Should the ORR amend the permitted rate of return in future quinquennial reviews, the regulator would raise or lower the Company's permitted charges to customers so as to achieve this rate of return. In other words, the cash flows would change but the RAB would not. The RAB is therefore a proxy for the present value of future cash flows.

In the most recent Access Charges Review, the ORR set out its purpose in setting this rate as:

a) reflecting risks in delivering the capital programme of works;

b) ensuring comparability between Network Rail and competitors for the delivery of enhancements; and

c) enabling the Company to raise debt at a reasonable price.

The rate of return set by the regulator is, at each quinquennial review date, consistent with the market discount rates for infrastructure assets. Movements in the market cost of capital within a review period would have a small effect on the valuation of the railway network. However, at the start of the next review period, the regulator will re-evaluate the rate of return and reset it to the market rate. Changes in the fair value of the railway network resulting from movements in the market rate would not be permanent – only lasting until the next review.

The Company's annual valuation includes a reassessment of this rate to determine whether it continues to reflect conditions in the market in between review dates. This assessment is by reference to movements in observable market data, including the risk-free cost of borrowing, and changes in the weighted average cost of capital of listed utilities with similar gearing ratios. The most recent assessment has shown that there has been no material change in cost of capital within the control period to date.

The following table shows the effect of changes in the market discount rate on the carrying value of the railway network and on the depreciation charge. The analysis only considers the effects of movements in the market discount rate until the end of the control period (2014), and not in perpetuity. This is because the regulator performs a review every five years, so the rate applicable to the income streams derived from the railway network will be rebased to the market every five years. The effects of changes in the market discount rate apply equally to increases and to decreases in discount rates.

	Change in cost of capital (basis points)	**31 March 2011**	31 March 2010
Change in fair value	25	**£273m**	£346m
	50	**£548m**	£691m
% change in fair value	25	**0.7%**	1.0%
	50	**1.5%**	1.9%
Change in annual depreciation charge	25	**£9m**	£12m
	50	**£18m**	£23m

These sensitivities are calculated by reference to the Regulatory Asset Base used by the ORR to determine the allowed return, equal to the regulatory determination of the cost of capital, as set out in the ORR's *Periodic Review 2008: Determination of Network Rail's outputs and funding 2009-14*. Twenty five and fifty basis points were chosen as management's assessment of reasonably possible changes in the market cost of capital.

The sensitivities calculated the discounted additional income or expense that could arise if the actual cost of capital varied from the regulatory cost of capital between quinquennial reviews.

Forecast performance variations

The annual valuation includes a review of changes in cash flow estimates and an assessment of current operational and economic conditions, as well as operational and political risk. These changes are reflected in the valuation so that the resulting fair value of the railway network remains current throughout the five years between periodic reviews.

Critical judgements

The valuation also includes the following critical judgements:

a) Cash flows remain stable and robust. The regulatory financial framework has remained robust and stable over recent years and is expected to continue to be so in the future.

12. Property, plant and equipment – the railway network continued

b) The residual value of the railway network is considered immaterial to assessing its annual depreciation charge. This is because evidence from other disused parts of the railway network indicates that the residual value is negligible and includes significant onerous obligations. In addition, the value of the land on which the railway network stands is immaterial to the value of the assets that comprise the network.

c) The quinquennial charges review sets out renewals allowances that can be added to the RAB. The allowances take account of input prices using the Infrastructure Output Prices Index (IOPI) as published by the Royal Institution of Chartered Surveyors. The expected future changes in IOPI in comparison to RPI, on which the Company's income flows are based, is a critical judgement to the railway network valuation. The expected future changes reduce the network valuation by £290m (2010: £nil). This forecast is based on management's expectations that IOPI will broadly track general economic inflation as measured by RPI over the remainder of the five-year period. The renewals allowances, and therefore the valuation, would change by £140m for every one per cent change in IOPI in comparison to RPI over the three years to the end of the current quinquennial review period at 31 March 2014.

Depreciated replacement cost

In the year ended 31 March 2009 Ove Arup and Partners reviewed Network Rail Infrastructure Limited's engineering assessment of the serviceable economic lives of the major asset categories that comprise the railway network and their depreciated replacement cost. They confirmed in writing to the Directors that the basis upon which the assessment had been prepared was reasonable.

The depreciated replacement cost of the network (after excluding the replacement cost of embankments, cuttings and tunnels) is estimated at £75bn (2010: £75bn).

As at 31 March 2011 the comparable valuation of the railway network according to the historical cost convention is £35,015m (2010: £32,157m).

As at 31 March 2011 and 31 March 2010 it has not been possible to identify the undepreciated capitalised interest or the undepreciated finance leases within the net book value of fixed assets. The undepreciated interest capitalised since the date of adoption of the network value at deemed cost on 1 April 2002 was £555m (2010: £457m). No finance leased assets have been acquired since 1 April 2002.

The depreciation charge for the year is calculated using the average carrying value for the year and the estimated weighted average remaining useful economic life of the railway network. The weighted average remaining useful economic life of the railway network was calculated using the engineering assessment of serviceable economic lives of the major categories of asset that comprise the railway network. The estimated remaining weighted average useful economic life of the network is currently 30 years (2010: 30 years).

At 31 March 2011, the Company had entered into contractual commitments in respect of capital expenditure amounting to £1,501m (2010: £1,436m).

13. Investment property

	Group and Company £m
Fair value	
At 1 April 2009	700
Additions	13
Transfers to property, plant and equipment	(10)
Disposals	(1)
Increase in fair value in the year	62
At 1 April 2010	**764**
Additions	15
Decrease in fair value in the year	(1)
At 31 March 2011	**778**

The fair value of the Group's investment properties at 31 March 2011 has been arrived at on the basis of a valuation carried out at that date by King Sturge, external valuers not connected with the Group, and by a chartered surveyor working for Network Rail.

The valuation, which conforms to International Valuation Standards, was arrived at by splitting the portfolio between one-off individual properties to be valued externally and the remainder of the portfolio to be valued under the Beacon method.

King Sturge provided independent valuations of 14 one-off individual properties, amounting to 12 per cent of the total valuation. The balance of the estate was valued under the Beacon method by splitting the portfolio into 12 homogeneous classes of property and areas. King Sturge independently assessed the appropriate yield to be adopted within each of these classes and areas. This enabled the directors to estimate market values by applying the provided yields to the net rental income from these properties, in accordance with a standard UK investment property valuation.

The property rental income earned by the Group from its investment property, all of which is leased out under operating leases, amounted to £76m (2010: £69m). Direct operating expenses arising on the investment properties in the year amounted to £5m (2010: £3m).

The Group's investment properties are let on a tenant repairing basis. The Group's maintenance obligations are limited to common areas and vacant property units.

14. Investment in subsidiaries: Company

Shares in Group undertakings	**2011 £m**	2010 £m
Beginning of year	**49**	49
Additions in year	**99**	–
End of year	**148**	49

The Company's subsidiaries are set out below:

Directly owned	Country of incorporation	Proportion of all classes of issued share capital owned by the Company	Principal activity
Network Rail Insurance Limited	Guernsey	100%	Insurance
Network Rail (CTRL) Limited	Great Britain	100%	Holds St Pancras concession and CTRL Railway Services Agreement
Network Rail Development Limited	Great Britain	100%	Holds 49.95% of the property joint venture Solum Regeneration LP
Solum Regeneration (GP) Limited	Great Britain	50%	Holds 0.1% of the property joint venture Solum Regeneration LP
Network Rail (Spacia) Limited	Great Britain	100%	Dormant
Network Rail (Stations) Limited	Great Britain	100%	Dormant
Network Rail (Projects) Limited	Great Britain	100%	Dormant
Network Rail (Property) Limited	Great Britain	100%	Dormant
Spacia (2002) Limited	Great Britain	100%	Dormant
Network Rail Pension Trustee Limited	Great Britain	Company limited by guarantee	Administration of defined contribution pension scheme
Shares held by a trustee			
Network Rail MTN Finance PLC	Great Britain	Structured Finance Management Limited	Dormant
Network Rail Infrastructure Finance PLC	Great Britain	Shares held by HSBC Trustee (C.I.) Limited	Issuer of the Debt Issuance Programme

The shares in Network Rail MTN Finance PLC and Network Rail Infrastructure Finance PLC are held by HSBC Trustee (C.I.) Limited and Structured Finance Management Limited, respectively, for charitable purposes. The sole purpose of these companies is to act as special purpose funding vehicles. The companies are treated as subsidiaries for accounting purposes as proceeds from debt issuances are lent on to Network Rail Infrastructure Limited and are used to finance the activities of the Company and to refinance the existing debt of the Group.

The Company's joint venture is set out below:

Joint venture	Country of incorporation	Proportion of all classes of capital owned by the Company	Principal activity
Solum Regeneration LP	Great Britain	50%	Property development

Aggregated amounts relating to joint ventures	**2011 £m**	2010 £m
Current assets	**5**	5

15. Inventories

	2011 Group and Company £m	2010 Group and Company £m
Raw materials and consumables	**108**	132

As at 31 March 2011 a provision of £28m was held in respect of inventories (2010: £18m).

16. Finance lease receivables

	Minimum lease payments		Present value of minimum lease payments	
	2011 Group and Company £m	2010 Group and Company £m	**2011 Group and Company £m**	2010 Group and Company £m
Amounts receivable under finance leases:				
Within one year	**2**	3	**1**	2
In the second to fifth years inclusive	**6**	7	**5**	6
After five years	**1**	2	**1**	2
	9	12	**7**	10
Less: unearned finance income	**(2)**	(2)	**n/a**	n/a
Present value of minimum lease payments receivable	**7**	10	**7**	10
Analysed as:				
Current finance lease receivables (recoverable within one year)	**1**	2	**1**	2
Non-current finance lease receivables (recoverable after one year)	**6**	8	**6**	8
	7	10	**7**	10

The Group has entered into finance lease arrangements with third parties for various types of telecommunications equipment. Leases are due to expire in 2017/18.

The interest rate inherent in the leases is fixed at the contract date for all of the lease term. The average effective interest rate contracted is approximately 8.4 per cent (2010: 8.4 per cent) per annum.

Finance lease receivable balances are secured over the equipment leased. The Group is not permitted to sell or repledge the collateral in the absence of default by the lessee.

The fair value of the Group's finance lease receivables at 31 March 2011 is estimated at £7m (2010: £9m) using a 3.4 per cent (2010: 3.5 per cent) discount rate based on the average cost of capital associated with the remaining life of the lease.

17. Other financial assets

Trade and other receivables

	2011 Group £m	2010 Group £m	**2011 Company £m**	2010 Company £m
Trade receivables	**305**	269	**305**	263
Capital grants receivable	**320**	94	**320**	94
Other taxation and social security	**32**	27	**32**	27
Other receivables	**37**	129	**37**	211
Prepayments and accrued income	**211**	201	**206**	186
	905	720	**900**	781

Trade receivables include an allowance for estimated irrecoverable amounts from the supply of services of £24m (2010: £18m). This allowance has been made by reference to past default experience. Average debtor days were 53 days (2010: 58 days).

The Directors consider that the carrying value of trade and other receivables approximates to their fair value. All balances are non-interest bearing and denominated in sterling. The Group provides fully for receivables overdue by over six months because historical experience is that such receivables are generally not recoverable. All other trade receivables are provided for on the basis of estimated irrecoverable amounts, determined by reference to past default experience.

The Group's and Company's credit risk is primarily attributable to its trade receivables. Around 95 per cent of the Group's income is received from train operating companies (TOCs) and in the form of revenue grants from Government. Franchises are issued to TOCs by the Department for Transport (DfT) in England and Wales and Transport Scotland in Scotland. The Group believes that amounts receivable from Government and the TOCs represent a high level of credit quality. This is because in the extraordinary circumstance that a TOC was financially distressed and unable to meet its obligations then provisions in the franchise agreements allow the DfT to take over services at any time. Before accepting any other new customer, the Group uses an external credit scoring system to assess the potential customer's credit quality.

Included in the Group's trade receivable balance are debtors with a carrying value of £14m (2010: £14m) which are past due at the reporting date for which the Group has not provided as there has not been a significant change in the credit quality and the amounts are still considered recoverable. The Group does not hold collateral over these balances. The average age of these receivables is 41 days (2010: 73 days).

17. Other financial assets continued

The following table shows the age of financial assets for the Group and Company which are past due and for which no specific provision has been raised:

	2011 Group £m	2010 Group £m	2011 Company £m	2010 Company £m
Past due by 1–28 days	**9**	5	**9**	5
Past due by 29–56 days	**1**	5	**1**	5
Past due by 57–84 days	**2**	3	**2**	3
Past due by 85–180 days	**2**	1	**2**	1
	14	14	**14**	14

Loan to immediate parent company

The loan to the immediate parent company of £397m (2010: £391m) is receivable in full in 2052. Interest is charged on an arm's length basis.

Loan to other Group company

The loan to other Group company of £104m in 2010 was to Network Rail (CTRL) Limited. The loan was repaid in the year.

18. Trade and other payables

Current liabilities: Trade and other payables	2011 Group £m	2010 Group £m	2011 Company £m	2010 Company £m
Trade creditors	**651**	637	**696**	613
Collateral held from banking counterparties	**159**	554	**–**	–
Payments received on account	**26**	14	**26**	14
Other creditors	**558**	459	**551**	595
Other interest accruals	**275**	311	**276**	311
Other accruals and deferred income	**1,154**	1,068	**1,146**	1,145
	2,823	3,043	**2,695**	2,678

The average credit period taken for trade purchases is 49 days (2010: 48 days).

Before accepting new suppliers, and upon letting significant contracts, the Company evaluates suppliers' creditworthiness using external credit scoring systems and other relevant data.

The Directors consider that the carrying value of trade and other payables approximates to their fair value. All balances are ordinarily non-interest bearing and denominated in sterling.

Non-current liabilities: Other payables	2011 Group £m	2010 Group £m	2011 Company £m	2010 Company £m
Deferred development income	**–**	18	**–**	18
Capital grants deferred income	**2,122**	1,747	**2,122**	1,747
Other payables	**171**	122	**171**	122
	2,293	1,887	**2,293**	1,887

19. Bank loans and overdrafts

	2011 Group £m	2010 Group £m	2011 Company £m	2010 Company £m
Bank loans and overdrafts	**1,226**	1,311	**324**	327
Bonds issued under the Debt Issuance Programme (less unamortised discount and fees)	**24,433**	24,292	**–**	–
Loans from subsidiaries	**–**	–	**24,349**	22,632
	25,659	25,603	**24,673**	22,959
The borrowings are repayable as follows:				
On demand or due within one year	**2,314**	2,223	**1,782**	241
Due within one to two years	**937**	2,360	**971**	2,204
Due within two to five years	**3,992**	1,988	**3,812**	1,816
Due in more than five years	**18,416**	19,032	**18,108**	18,698
	25,659	25,603	**24,673**	22,959
Less: amounts repayable within one year (shown under current liabilities):				
Bank loans and overdrafts	**(3)**	(102)	**(3)**	–
Bonds issued under the Debt Issuance Programme (less unamortised discount and fees)	**(2,311)**	(2,121)	**–**	–
Loans from subsidiaries	**–**	–	**(1,779)**	(241)
Amounts repayable within one year	**(2,314)**	(2,223)	**(1,782)**	(241)
Amounts repayable after more than one year	**23,345**	23,380	**22,891**	22,718

All borrowings are denominated in or swapped into sterling.

19. Bank loans and overdrafts continued

Bonds issued under the Debt Issuance Programme are analysed as follows:

	2011 Group £m	2010 Group £m	2011 Company £m	2010 Company £m
1.085% sterling index linked bond due 2052	**111**	106	**–**	–
0% sterling index linked bond due 2052	**103**	102	**–**	–
1.003% sterling index linked bond due 2051	**21**	20	**–**	–
0.53% sterling index linked bond due 2051	**107**	102	**–**	–
0.517% sterling index linked bond due 2051	**106**	101	**–**	–
0% sterling index linked bond due 2051	**115**	108	**–**	–
0.678% sterling index linked bond due 2048	**107**	101	**–**	–
1.125% sterling index linked bond due 2047	**3,587**	3,411	**–**	–
0% sterling index linked bond due 2047	**65**	67	**–**	–
1.1335% sterling index linked bond due 2045	**44**	41	**–**	–
1.5646% sterling index linked bond due 2044	**238**	227	**–**	–
1.1565% sterling index linked bond due 2043	**49**	46	**–**	–
1.1795% sterling index linked bond due 2041	**60**	57	**–**	–
1.2219% sterling index linked bond due 2040	**236**	225	**–**	–
1.2025% sterling index linked bond due 2039	**65**	62	**–**	–
4.6535% sterling bond due 2038	**100**	100	**–**	–
1.375% sterling index linked bond due 2037	**4,085**	3,876	**–**	–
4.75% sterling bond due 2035	**1,224**	1,223	**–**	–
1.6492% sterling index linked bond due 2035	**359**	343	**–**	–
4.375% sterling bond due 2030	**870**	869	**–**	–
1.75% sterling index linked bond due 2027	**3,193**	3,035	**–**	–
4.57% Norwegian krone bond due 2026*	**15**	16	**–**	–
4.615% Norwegian krone bond due 2026*	**54**	58	**–**	–
1.9618% sterling index linked bond due 2025	**301**	288	**–**	–
4.75% sterling bond due 2024	**728**	726	**–**	–
2.28% Japanese yen bond due 2021*	**81**	73	**–**	–
2.315% Japanese yen bond due 2021*	**82**	74	**–**	–
2.15% Japanese yen bond due 2021*	**80**	72	**–**	–
2.76% Swiss franc bond due 2021	**204**	193	**–**	–
4.625% sterling bond due 2020	**997**	996	**–**	–
4.4% Canadian dollar bond due 2016	**321**	333	**–**	–
6% Australian dollar bond due 2016	**322**	294	**–**	–
4.875% sterling bond due 2015	**994**	993	**–**	–
1.5% US dollar bond due 2014	**938**	–	**–**	–
2.5% sterling bond due 2014	**748**	–	**–**	–
3.5% US dollar bond due 2013	**778**	821	**–**	–
1.75% US dollar bond due 2013	**634**	656	**–**	–
4.875% sterling bond due 2012	**998**	997	**–**	–
2% US dollar bond due 2012	**624**	669	**–**	–
0.54% US dollar bond due 2012	**62**	–	**–**	–
4.375% sterling bond due 2011	**–**	449	**–**	–
5.25% US dollar bond due 2011	**627**	691	**–**	–
3% US dollar bond due 2011	**–**	658	**–**	–
5.5% Australian dollar bond due 2010	**–**	513	**–**	–
5.125% sterling bond due 2010	**–**	500	**–**	–
	24,433	24,292	**–**	–

* Amounts are shown as fair value through profit and loss. All other amounts are shown net of unamortised discount and fees.

19. Bank loans and overdrafts continued

The amounts repayable on maturity relating to those bonds designated to be measured at fair value through profit and loss, are as follows:

	2011 Group £m	2010 Group £m	2011 Company £m	2010 Company £m
4.57% Norwegian krone bond due 2026	**16**	16	**–**	–
4.615% Norwegian krone bond due 2026	**56**	55	**–**	–
2.28% Japanese yen bond due 2021	**75**	70	**–**	–
2.315% Japanese yen bond due 2021	**75**	70	**–**	–
2.15% Japanese yen bond due 2021	**75**	70	**–**	–
	297	281	**–**	–

Bank loans and overdrafts are analysed as follows:

	2011 Group £m	2010 Group £m	2011 Company £m	2010 Company £m
Index-linked European Investment Bank due 2037	**402**	384	**–**	–
Royal Bank of Scotland (novated from HSBC Bank) due 2019 repayable by instalments	**208**	208	**208**	208
Barclays Bank due 2017 repayable by instalments	**47**	50	**47**	50
Royal Bank of Scotland due 2017 repayable by instalments	**69**	69	**69**	69
5.57% European Investment Bank due 2013	**200**	200	**–**	–
5.77% European Investment Bank due 2012	**300**	300	**–**	–
6.42% European Investment Bank due 2011	**–**	100	**–**	–
	1,226	1,311	**324**	327

At 31 March 2011 and 2010 the Group had the following undrawn committed borrowing facilities:

	2011 Drawn £m	2011 Undrawn £m	2011 Total £m	2010 Drawn £m	2010 Undrawn £m	2010 Total £m
Working capital facility	**–**	**1,000**	**1,000**	–	1,000	1,000
Standby facility A	**–**	**4,000**	**4,000**	–	4,000	4,000
	–	**5,000**	**5,000**	–	5,000	5,000

Undrawn committed facilities expire as follows:

	2011 Group £m	2010 Group £m
Within one year	**–**	–
Within one to two years	**1,000**	1,000
Within two to five years	**–**	–
In more than five years	**4,000**	4,000
	5,000	5,000

In addition the Secretary of State for Transport has provided unlimited financial indemnity in respect of borrowings under the Debt Issuance Programme.

20. Derivative financial instruments

	2011 Group Fair value £m	2011 Group Notional amounts £m	2011 Company Fair value £m	2011 Company Notional amounts £m
Cash flow hedges				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	440	1,222	–	–
Fair value hedges				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	103	547	–	–
Non-hedge accounted derivatives				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	134	198	–	–
Forward starting real interest rate swaps and gilt locks	3	100	–	–
Forward foreign exchange contracts	–	1	–	1
	680	2,068	–	1
Included in non-current assets	576	1,520	–	–
Included in current assets	104	548	–	1
Derivative financial instrument assets	680	2,068	–	1
Cash flow hedges				
Cross-currency swaps to hedge debt under the Debt Issuance Programme	(29)	658	–	–
Interest rate swaps	(113)	1,501	(113)	1,501
Forward starting interest rate swaps	(336)	5,870	(336)	5,870
Fair value hedges				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	(70)	1,698	–	–
Non-hedge accounted derivatives				
Interest rate swaps to hedge debt issued under the Debt Issuance Programme	(80)	870	(80)	870
Forward starting real interest rate swaps and gilt locks	(319)	1,746	–	–
Forward foreign exchange contracts	–	2	–	2
Embedded derivative in inter-company borrowings	–	–	(210)	6,169
	(947)	12,345	(739)	14,412
Included in current liabilities	(373)	3,126	(234)	6,829
Included in non-current liabilities	(574)	9,219	(505)	7,583
Derivative financial instrument liabilities	(947)	12,345	(739)	14,412

20. Derivative financial instruments continued

	2011 Group Fair value £m	2011 Group Notional amounts £m	2010 Group Fair value £m	2010 Group Notional amounts £m
Cash flow hedges				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	**411**	**1,880**	445	1,512
Forward starting interest rate swaps	**(336)**	**5,870**	(359)	6,690
Interest rate swaps	**(113)**	**1,501**	(141)	1,551
Fair value hedges				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	**33**	**2,245**	430	2,454
Non-hedge accounted derivatives				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	**134**	**198**	104	198
Forward foreign exchange contracts	**–**	**3**	1	68
Interest rate swaps to hedge debt issued under the Debt Issuance Programme	**(80)**	**870**	–	–
Forward starting real interest rate swaps and gilt locks	**(316)**	**1,846**	(198)	2,452
	(267)	**14,413**	282	14,925

21. Provisions: Group and Company

	£m
At 1 April 2009	9
Reclassification in the year	40
Additional provision in the year	10
Utilisation of provision	(2)
At 1 April 2010	**57**
Additional provision in the year	10
Utilisation of provision	(44)
Release of provision	(6)
At 31 March 2011	**17**
Included in current liabilities	17
Included in non-current liabilities	–
	17

The Group has provided against a number of commercial claims from third parties arising from interpretations of legal contracts or past events for which settlement is expected to be achieved in the next year, but could be deferred to future years depending on the legal interpretation of rights and responsibilities under the contracts as well as commercial negotiation. The provisions that have been recorded represent the Directors' best estimate of the expenditure required to settle the obligation, often with the benefit of legal advice.

Contingent liability

Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the balance sheet date. The nature of these claims means that there is some uncertainty with regard to the value that they will be settled at. If the outcomes of the claims are different to the assumptions underpinning the Directors' best estimates then a further liability may arise.

The Group's lawyers have advised that the provisions for the claims are realistic and no further provision is made for contingent liabilities as the Directors do not consider there is any probable loss. In accordance with paragraph 92 of IAS 37 the Directors consider that further disclosure regarding the nature and amount of the disputes beyond that disclosed here could be expected to prejudice seriously the position of the Company.

22. Deferred tax

The following are the major deferred tax liabilities and assets recognised by the Group and Company and movement thereon during the current and prior years.

Group	Accelerated tax depreciation £m	Revaluation of railway network £m	Short-term timing differences including retirement benefit obligations £m	Derivatives £m	Tax losses £m	Total £m
At 1 April 2009	3,315	1,723	(191)	(120)	(1,264)	3,463
Charge/(credit) to income	91	–	(10)	24	10	115
Credit to other comprehensive income	–	(289)	(82)	(7)	–	(378)
At 1 April 2010	**3,406**	**1,434**	**(283)**	**(103)**	**(1,254)**	**3,200**
Charge/(credit) to income	42	–	(9)	11	73	117
(Credit)/charge to other comprehensive income	–	(45)	160	(55)	–	60
At 31 March 2011	**3,448**	**1,389**	**(132)**	**(147)**	**(1,181)**	**3,377**

Company	Accelerated tax depreciation £m	Revaluation of railway network £m	Short-term timing differences including retirement benefit obligations £m	Derivatives £m	Tax losses £m	Total £m
At 1 April 2009	3,315	1,723	(191)	(101)	(1,271)	3,475
Charge/(credit) to income	87	–	(10)	–	13	90
Credit to other comprehensive income	–	(289)	(82)	(11)	–	(382)
At 1 April 2010	**3,402**	**1,434**	**(283)**	**(112)**	**(1,258)**	**3,183**
Charge/(credit) to income	43	–	(9)	–	58	92
(Credit)/charge to other comprehensive income	–	(45)	160	11	–	126
At 31 March 2011	**3,445**	**1,389**	**(132)**	**(101)**	**(1,200)**	**3,401**

Certain deferred tax assets and liabilities have been offset. The following is the analysis of the gross deferred tax balances:

	2011 £m	2010 £m
Deferred tax liabilities	**4,833**	4,840
Deferred tax assets	**(1,456)**	(1,640)
	3,377	3,200

23. Obligations under finance leases

	Minimum lease payments		Present value of minimum lease payments	
	2011 Group and Company £m	2010 Group and Company £m	**2011 Group and Company £m**	2010 Group and Company £m
Amounts payable under finance leases:				
Within one year	**1**	–	**1**	–
In the second to fifth years inclusive	**1**	1	**1**	1
After five years	**–**	1	**–**	1
	2	2	**2**	2
Less: future finance charges	**–**	–	**n/a**	n/a
Present value of lease obligations	**2**	2	**2**	2
Less: amounts repayable within one year (shown under current liabilities)	**–**	–	**–**	–
Amounts repayable after more than one year	**2**	2	**2**	2

The Group leases certain fixtures and fittings under finance leases from third parties. All lease obligations are denominated in sterling. The fair value of the Group's lease obligations approximates to their carrying amount. The Group's obligations under finance leases are secured by the lessors' charges over the leased assets. For the year ended 31 March 2011, the effective borrowing rate was 7.4 per cent (2010: 7.4 per cent). Interest rates are fixed at contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rent payments.

24. Share capital

	2011 Group and Company £m	2010 Group and Company £m
Authorised:		
50,200,000 ordinary shares of 0.1p each	**–**	–
500,000,000 redeemable shares of £1 each	**500**	500
	500	500
Issued and fully paid:		
50,084,937 ordinary shares of 0.1p each	**–**	–
160,000,000 redeemable shares of £1 each	**160**	160
	160	160

The Company has the option to repurchase any or all of the redeemable shares at any date after 31 March 2003. No premium is repayable on such redemption and the option to repurchase has no expiry date. The redeemable shareholders have no right to redemption at their instigation. Redeemable shares do not carry voting rights, or rank for dividend, but may do so if the Company passes a resolution to that effect.

25. Notes to the statements of cash flows

	2011 Group £m	2010 Group £m	2011 Company £m	2010 Company £m
Operating profit	**2,028**	1,981	**1,999**	1,966
Adjustments for:				
Depreciation of the railway network	**1,271**	1,193	**1,271**	1,193
Amortisation of capital grants	**(54)**	(52)	**(54)**	(52)
Amortisation of intangible assets	**1**	1	**–**	–
Decrease/(increase) in provisions	**(39)**	48	**(39)**	48
Operating cash flows before movements in working capital	**3,207**	3,171	**3,177**	3,155
(Decrease)/increase in inventories	**24**	(44)	**24**	(44)
Decrease in receivables	**52**	67	**105**	122
Increase/(decrease) in payables	**139**	(29)	**65**	23
Cash generated from operations	**3,422**	3,165	**3,371**	3,256
Income taxes paid	**–**	(20)	**–**	(18)
Interest paid	**(936)**	(911)	**(929)**	(868)
Net cash generated from operating activities	**2,486**	2,234	**2,442**	2,370

Cash and cash equivalents

Cash and cash equivalents (which are represented as a single class of assets on the face of the Balance sheet) comprise cash at bank, collateral and money market deposit investments, all of which are on call with the exception of £21m of short-term deposits with an average term of one day (2010: one day) from the Balance sheet date. In 2010/11 cash and money market deposits had an average maturity of one day (2010: six days) from the Balance sheet date.

26. Analysis of changes in net debt

	At 1 April 2010 £m	Cash flows £m	Non-cash movements £m	Capital accretion £m	Amortisation of discount £m	Fair value through profit and loss and fair value hedging movements £m	Foreign exchange movements £m	At 31 March 2011 £m
Cash and cash equivalents*	1,767	(1,155)	–	–	–	–	–	**612**
Borrowings due within one year	(2,223)	1,860	(2,360)	–	–	65	344	**(2,314)**
Borrowings due after one year	(23,380)	(1,716)	2,360	(657)	–	32	16	**(23,345)**
Obligations under finance leases	(2)	–	–	–	–	–	–	**(2)**
	(23,838)	**(1,011)**	**–**	**(657)**	**–**	**97**	**360**	**(25,049)**

	At 1 April 2009 £m	Cash flows £m	Non-cash movements £m	Capital accretion £m	Amortisation of discount £m	Fair value through profit and loss and fair value hedging movements £m	Foreign exchange movements £m	At 31 March 2010 £m
Cash and cash equivalents*	661	1,106	–	–	–	–	–	1,767
Borrowings due within one year	(1,773)	1,189	(1,970)	(2)	(2)	231	104	(2,223)
Borrowings due after one year	(21,192)	(3,826)	1,970	(345)	(7)	(30)	50	(23,380)
Obligations under finance leases	(3)	1	–	–	–	–	–	(2)
	(22,307)	(1,530)	–	(347)	(9)	201	154	(23,838)

* Excludes collateral held of £159m (2010: £554m).

27. Operating lease arrangements

The Group and Company as lessee

	2011 Group and Company £m	2010 Group and Company £m
Minimum lease payments under operating leases recognised in Income statement in the year	**40**	66

At the Balance sheet date, the Group and Company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2011 Group and Company £m	2010 Group and Company £m
Within one year	**36**	38
In the second to fifth years inclusive	**82**	77
After five years	**102**	70
	220	185

Operating lease payments largely represent rentals payable by the Group and Company for certain of its office properties. Leases are negotiated for an average term of seven years and rentals fixed for an average of three years. In addition rentals are paid for land adjacent to the railway required for maintenance and renewal activities.

The Group and Company as lessor

Operating lease rentals earned in the year by the Group and Company were £261m (2010: £466m). This amount includes property rental income of £244m (2010: £206m), as disclosed in Note 3, and a portion of track access income (being income earned from station and depot leases to train operating companies).

At the Balance sheet date, the Group and Company had contracted with customers for the following future minimum lease payments:

	2011 Group and Company £m	2010 Group and Company £m
Within one year	**395**	315
In the second to fifth years inclusive	**861**	739
After five years	**1,103**	1,022
	2,359	2,076

28. Funding and financial risk management

Introduction

The Company's ultimate parent company is Network Rail Limited, a company limited by guarantee without shareholders. The Group is almost entirely debt funded. Debt is issued through a special purpose financing company (Network Rail Infrastructure Finance PLC) which is not a member of the Network Rail Limited Group but is treated as a subsidiary for accounting purposes. The majority of the Group's debt is issued by Network Rail Infrastructure Finance PLC under the Debt Issuance Programme (DIP) which has been highly rated (AAA by Standard & Poor's, Aaa by Moody's and AAA by Fitch). The DIP is supported by a financial indemnity from the Secretary of State for Transport which expires in 2052.

The DIP allows access, through a single platform, to the widest possible sources of funding, at the lowest possible cost, including the long-term capital markets. This gives Network Rail a stable base for funding a continuing programme of long-term investments in the national rail network. Debt is issued in a number of currencies and a range of maturities which gives rise to interest rate, foreign currency and inflation risk. Financial risk management aims to mitigate these risks.

Externally imposed capital requirements

The financial framework in which Network Rail operates is framed by the value of its debt, and the regulatory asset base (RAB). The Network Rail Group raises finance by issuing debt and therefore manages its debt as the key part of its capital. Network Rail manages its debt in relation to the RAB and its finance costs in relation to the allowed return on the RAB.

RAB is the Office of Rail Regulation's (the ORR) valuation of Network Rail's assets. This is an important business ratio because the value of the RAB and the amount of debt that the business can sustain are, generally speaking, closely related. Network Rail's debts cannot exceed the value of the RAB; a debt to RAB ratio of significantly less than 100 per cent indicates that the business is more robust to future cost shocks (because it is more likely to be able to sustain the additional debt that would arise from any losses incurred).

Network Rail's charges to customers are determined by the ORR. A key component of these charges is the allowed return on the RAB, as this is set at the ORR's assessment of the weighted average cost of capital in this market.

The RAB and regulatory debt are reconciled to property, plant and equipment (in Note 12) and net debt (in Note 26) as follows:

The debt to RAB ratio is based on regulatory net debt, which recognises debt at hedged rates.

	2011 £m	2010 £m
Net debt note per Note 26	**(25,049)**	(23,838)
Revaluations and remeasurements	**573**	1,019
Regulatory net debt	**(24,476)**	(22,819)

The RAB used to calculate the debt to RAB ratio is:

	2011 £m	2010 £m
Railway network per Note 12	**39,577**	36,629
Investment properties	**778**	764
Capital grant funded assets	**(2,086)**	(1,736)
Other fair value adjustments	**325**	69
RAB	**38,594**	35,726

The debt to RAB ratio at 31 March 2011 and 2010 was as follows:

	2011	2010
Debt: RAB ratio	**63.4%**	63.9 %

The Company owns and operates Britain's rail network under licence from the ORR. The licence imposes conditions on the Company with regard to its net debt. Should the value of the Company's qualifying net debt exceed 70 per cent of the ORR's RAB then the ORR will be formally notified.

Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised in respect of each class of financial asset, financial liability and equity instrument are disclosed in Note 2 to the financial statements.

28. Funding and financial risk management continued

Summary table of financial assets and liabilities

The following table presents the carrying amounts and the fair values of the Group's and Company's financial assets and liabilities at 31 March 2011 and 2010.

The fair values of the financial assets and liabilities are recorded at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The following methods and assumptions were used to estimate the fair values where balances were not already held at fair value:

- bank loans – based on market data at the Balance sheet date and the net present value of discounted cash flows
- certain bonds issued under the Debt Issuance Programme – based on market data at the Balance sheet date. Where market data is not available valuations have been obtained from dealing banks.

For cash and cash equivalents, finance lease receivables, trade and other payables and trade and other receivables, fair value equates to carrying value.

Group	2011 Carrying value £m	2011 Fair value £m	2010 Carrying value £m	2010 Fair value £m
Financial assets				
Cash and cash equivalents	**771**	**771**	2,321	2,321
Other non-derivative financial assets				
Loan to immediate parent company	**397**	**397**	391	391
Finance lease receivables	**7**	**7**	10	10
Trade and other receivables (less prepayments and accrued income and other taxation and social security)	**662**	**662**	492	492
Derivatives				
Derivatives designated as cash flow hedging instruments	**440**	**440**	445	445
Derivatives designated as fair value hedging instruments	**103**	**103**	437	437
Other derivatives	**137**	**137**	117	117
Total derivatives	**680**	**680**	999	999
Total financial assets	**2,517**	**2,517**	4,213	4,213
Financial Liabilities				
Financial liabilities held at amortised cost				
Obligations under finance leases	**(2)**	**(2)**	(2)	(2)
Bank loans	**(1,226)**	**(1,255)**	(1,311)	(1,382)
Bonds issued under the Debt Issuance Programme	**(24,121)**	**(26,008)**	(21,163)	(22,873)
Financial liabilities designated as fair value through profit and loss				
Bonds issued under the Debt Issuance Programme	**(312)**	**(312)**	(3,129)	(3,129)
Total borrowing	**(25,661)**	**(27,577)**	(25,605)	(27,386)
Trade and other payables	**(2,826)**	**(2,826)**	(3,157)	(3,157)
Derivatives				
Derivatives designated as cash flow hedging instruments	**(478)**	**(478)**	(500)	(500)
Derivatives designated as fair value hedging instruments	**(70)**	**(70)**	(7)	(7)
Other derivatives	**(399)**	**(399)**	(210)	(210)
Total derivatives	**(947)**	**(947)**	(717)	(717)
Total financial liabilities	**(29,434)**	**(31,350)**	(29,479)	(31,260)

28. Funding and financial risk management continued

Company

	2011 Carrying value £m	2011 Fair value £m	2010 Carrying value £m	2010 Fair value £m
Financial assets				
Other non-derivative financial assets				
Loan to immediate parent company	**397**	**397**	391	391
Loan to other Group company	**–**	**–**	104	104
Finance lease receivables	**7**	**7**	10	10
Trade and other receivables	**662**	**662**	568	568
Derivatives				
Other derivatives	**–**	**–**	1	1
Total derivatives	**–**	**–**	1	1
Total financial assets	**1,066**	**1,066**	1,074	1,074
Financial Liabilities				
Financial liabilities held at amortised cost				
Obligations under finance leases	**(2)**	**(2)**	(2)	(2)
Bank loans and overdrafts	**(324)**	**(324)**	(327)	(327)
Loans from subsidiaries	**(24,349)**	**(24,349)**	(22,690)	(22,690)
Total borrowing	**(24,675)**	**(24,675)**	(23,019)	(23,019)
Trade and other payables	**(2,698)**	**(2,698)**	(2,792)	(2,792)
Derivatives				
Derivatives designated as cash flow hedging instruments	**(449)**	**(449)**	(499)	(499)
Embedded derivatives in inter-company borrowing	**(210)**	**(210)**	(121)	(121)
Other derivatives	**(80)**	**(80)**	–	–
Total derivatives	**(739)**	**(739)**	(620)	(620)
Total financial liabilities	**(28,112)**	**(28,112)**	(26,431)	(26,431)

Derivatives

The Group (including the Group's special purpose financing company, Network Rail Infrastructure Finance PLC) and Company use derivative financial instruments to reduce exposure to foreign exchange risk and interest rate movements. The Group and Company do not use derivative financial instruments for speculative purposes. Certain derivatives are designated as hedges, and those derivatives that are not hedge accounted are fair valued immediately through the income statement. The Group and Company have a comprehensive risk management process.

The Board of Network Rail Limited (the ultimate parent company of NRIL) through a treasury sub-committee (the Treasury Committee) have approved and monitor the risk management processes, including documented treasury policies, counterparty limits, controlling and reporting structures.

The use of derivative instruments can give rise to credit and market risk. Market risk is the possibility that future changes in foreign exchange rates and interest rates may make a derivative more or less valuable. Since the Group and Company use derivatives for risk management, market risk relating to derivative instruments will principally be offset by changes in the valuation of the underlying assets, liabilities or transactions being hedged.

Credit risk

The credit risk for all classes of derivative financial instruments and other funds is limited because counterparties are banks with high credit ratings assigned by international credit-rating agencies. The Treasury Committee authorises the policy for setting counterparty limits based on credit ratings. The Group and Company spread their exposure over a number of counterparties, and have strict policies on how much exposure can be assigned to each counterparty. The concentration and amount of the Group's investments varies depending on the level of surplus liquidity the Group chooses to hold at any point in time. However, because of the strict criteria governing counterparty suitability the risk is mitigated. The Treasury Committee also authorises the investment and borrowing instruments that can be used.

For debt designated as fair value through profit and loss (FVTPL) there has been no change as a result of credit risk changes. The losses in the income statement arising from the remeasurement of FVTPL debt items of £20m (2010: £8m) are all attributable to changes in market risk.

The credit risk with regard to all classes of derivative financial instruments is limited because Network Rail has arrangements in place which limit each bank to a threshold (based on credit ratings), which if breached requires the bank to post collateral in cash or eligible securities. The members of the banking group are required to post collateral on positive mark to market swaps above the threshold. At 31 March 2011 the fair value of collateral held was £159m (2010: £554m). The Group is the beneficial owner of this collateral. The Group is free to invest or otherwise utilise the collateral at its discretion, subject to acting within the authority sanctioned by the Treasury Committee. The reduction in collateral is mainly due to the maturity of in the money cross-currency swaps.

28. Funding and financial risk management continued

Receivables consist of a small number of counterparties. The Group does not have any significant credit risk exposure to any single counterparty and has considered the creditworthiness of debtors. For further detail on the creditworthiness of customers and suppliers, see Notes 17 (Trade and other receivables) and 18 (Trade and other payables).

The Group considers its maximum exposure to credit risk to be the sum of its financial assets as set out on page 109.

Foreign exchange risk

Network Rail is exposed to currency risks from its investing, financing and operating activities. Foreign exchange risk for all currencies is managed by the use of forward exchange contracts and currency swaps to limit the effects of movements in exchange rates on foreign currency denominated liabilities.

It is estimated that a general increase of ten percentage points in the value of any currency against sterling would have no material effect on the Group or Company's profit before tax or equity due to all currency positions being 100 per cent hedged and therefore no sensitivity analysis is produced.

Interest rate and inflation risk

The Group and Company is exposed to changes in interest rates as funds are borrowed at both fixed and floating interest rates. The hedging strategy approved by the Treasury Committee defines the appropriate mix between fixed and floating borrowings. Cross-currency and interest rate swap contracts are used to manage the fixed/floating ratio.

Debt with a carrying value of £25,313m (2010: £23,968m) is arranged at or swapped into fixed interest rates and exposes the Group to fair value interest rate risk. Other borrowings were arranged at or swapped into floating rates, thus exposing the Group to cash flow interest rate risk.

The Group and Company have notional values of £6,540m (2010: £6,690m) of forward stating interest rate swaps which hedge Control Period 4. The average rate on these swaps is 5.03 per cent (2010: 5.05 per cent). The Group also has notional values of £100m (2010: £325m) of real rate swaps with an average real rate of –0.30 per cent (2010: –0.28 per cent) and notional values of £1,746m (2010: £2,127m) of gilt locks with an average real rate of 1.64 per cent (2010: 1.35 per cent).

The Group and Company have certain debt issuances which are index-linked and so are exposed to movements in inflation rates. The Group and Company do not enter into any derivative arrangements to hedge their exposure to inflation in relation to their index-linked debt, but rather to mitigate the effects of inflation on the Group's retail price index-linked revenue streams.

Sensitivity analysis

This sensitivity analysis has been determined based on the exposure to interest rates and inflation for both derivative and non-derivative financial instruments at the Balance sheet date. A one per cent increase or decrease represents management's assessment of the reasonably possible changes in average interest rates and inflation.

	Group and Company 31 March 2011		Group and Company 31 March 2010	
	Impact on the Income statement £m	Impact on equity £m	Impact on the Income statement £m	Impact on equity £m
1% change in the GBP interest rate	**9**	**119**	–	263
1% change in the GBP RPI on Index Linked Bonds	**124**	**–**	120	–

A one per cent increase in the GBP interest rate would result in a credit to the Income statement and equity and a one per cent decrease in the GBP interest rate would result in a debit to the Income statement and equity.

A one per cent increase in the GBP RPI would result in a debit to the Income statement and a one per cent decrease in the GBP RPI would result in a credit to the Income statement.

GBP interest rate sensitivities have been calculated by comparing the average rates of the derivative financial instruments to the market rate for similar instruments.

The impact of a change in GBP RPI has been calculated by applying a change of one per cent to the RPI at the Balance sheet date to the carrying value of the index linked bonds.

The Group and Company believe that the above analysis is unrepresentative of the risks inherent in issuing index-linked debt. Franchised track access and grant income constitute £5,408m (2010: £5,387m) of revenue which is far in excess of an index-linked interest expense of £171m (2010: £150m). Currently, these sources of income are contractually index-linked and, whilst there is no absolute contractual guarantee for future regulatory control periods that this will continue, the Group and Company are highly confident that this will continue to be the case. Therefore, the natural hedge that exists between finance costs and revenue mitigates the risk of RPI movements.

28. Funding and financial risk management continued

There have been no index-linked issuances during the year as the proportion of index-linked debt to nominal debt was in line with the 50:50 ratio set by the Treasury Committee. The Group cancelled £225m of real rate swaps and £381m of surplus gilt locks at a cost of £15m, reducing the index-linked hedging portfolio by a total of £606m. The sensitivity to movements in interest rates of the gilt lock portfolio is as follows:

Change in real rate	Effect on Income statement 2011	2010
1 % increase	**£338m increase**	£418m increase
1 % decrease	**£412m decrease**	£518m decrease

Embedded derivatives

The obligations and rights of Network Rail Infrastructure Limited under the inter-company loan agreement with its financing company give rise to an embedded derivative in that agreement which reflects the external currency and interest rates risks to which the financing companies are exposed. The embedded derivative is treated as a separate derivative and is accounted for in accordance with the accounting policy disclosed in Note 2.

Liquidity risk management

The ultimate responsibility for liquidity risk management rests with the Board of Directors. The policy manual ratified by the Treasury Committee includes an appropriate liquidity risk management framework covering the Group's short, medium and long-term funding and liquidity management requirements. Treasury is subject to regular internal audits. Treasury provides sufficient liquidity to meet the Group and Company's needs, while reducing financial risks and prudently maximising interest receivable and credit risk on surplus cash.

The Group manages liquidity risk by maintaining sufficient facilities to cover at least one year's working capital requirement by continuously monitoring forecast and actual cash flows. Included in Note 19 is a description of additional undrawn facilities that the Group has at its disposal to further reduce liquidity risk.

The following table details the Group and Company's remaining contractual maturity for their financial liabilities. The table has been drawn up on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group or Company can be required to pay and, therefore, differs from both the carrying value and the fair value. The table includes both interest and principal cash flows.

Group	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	**Total £m**
31 March 2011					
Non derivative financial liabilities					
Bank loans and overdrafts	**49**	**340**	**275**	**1,500**	**2,164**
Bonds issued under the Debt Issuance Programme					
– Sterling denominated DIP bonds	**1,301**	**252**	**2,468**	**6,358**	**10,379**
– Sterling denominated index-linked DIP bonds	**176**	**182**	**585**	**41,063**	**42,006**
– Foreign currency denominated bonds	**1,173**	**581**	**1,771**	**689**	**4,214**
Finance lease liabilities	**–**	**–**	**1**	**–**	**1**
Trade and other payables	**2,490**	**61**	**–**	**–**	**2,551**
Derivative financial liabilities					
Net settled derivative contracts	**423**	**140**	**227**	**131**	**921**
Gross settled derivative contracts – receipts	**(1,173)**	**(581)**	**(1,771)**	**(689)**	**(4,214)**
Gross settled derivative contracts – payments	**1,342**	**744**	**2,001**	**640**	**4,727**
	5,781	**1,719**	**5,557**	**49,692**	**62,749**

Company	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	**Total £m**
31 March 2011					
Non derivative financial liabilities					
Inter-company loan	**2,683**	**1,339**	**5,049**	**49,271**	**58,342**
Bank loans and overdrafts	**16**	**16**	**50**	**339**	**421**
Finance lease liabilities	**–**	**–**	**1**	**–**	**1**
Trade and other payables	**2,361**	**61**	**–**	**–**	**2,422**
Derivative financial liabilities					
Net settled derivative contracts	**238**	**86**	**140**	**–**	**464**
	5,298	**1,502**	**5,240**	**49,610**	**61,650**

28. Funding and financial risk management continued

Group

	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	Total £m
31 March 2010					
Non derivative financial liabilities					
Bank loans and overdrafts	155	49	596	1,763	2,563
Bonds issued under the Debt Issuance Programme					
– Sterling denominated DIP bonds	1,277	1,282	699	7,591	10,849
– Sterling denominated index-linked DIP bonds	169	175	574	35,056	35,974
– Foreign currency denominated bonds	1,341	1,521	1,688	1,185	5,735
Finance lease liabilities	–	–	1	1	2
Trade and other payables	2,674	122	–	–	2,796
Derivative financial liabilities					
Net settled derivative contracts	340	87	148	57	632
Gross settled derivative contracts – receipts	(1,341)	(1,521)	(1,688)	(1,185)	(5,735)
Gross settled derivative contracts – payments	975	691	1,479	871	4,016
	5,590	**2,406**	**3,497**	**45,339**	**56,832**

Company

	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	Total £m
31 March 2010					
Non derivative financial liabilities					
Inter-company loan	2,927	3,011	3,507	45,239	54,684
Bank loans and overdrafts	16	16	49	356	437
Finance lease liabilities	–	–	1	1	2
Trade and other payables	2,309	122	–	–	2,431
31 March 2011					
Derivative financial liabilities					
Net settled derivative contracts	199	72	106	–	377
	5,451	**3,221**	**3,663**	**45,596**	**57,931**

Cash flow hedges
Contractual payments on derivatives designated as cash flow hedges impact the Income statement as they occur between the Balance sheet date, and will all have matured within the next 11 years.

Borrowings
Details of the Group's undrawn committed facilities and types of debt instrument used can be found in Note 19.

Hedge ineffectiveness
At 31 March 2011 the Group has recognised £44m (2010: £68m) of ineffectiveness arising from the Group's cash flow hedges in the Income statement.

28. Funding and financial risk management continued

Fair value measurements recognised in the statement of balance sheets

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	2011			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets at FVTPL				
Derivative financial assets	**–**	**680**	**–**	**680**
Financial liabilities at FVTPL				
Derivative financial liabilities	**–**	**(947)**	**–**	**(947)**
Financial liabilities designated at FVTPL	**(312)**	**–**	**–**	**(312)**
	(312)	**(947)**	**–**	**(1,259)**
Total	**(312)**	**(267)**	**–**	**(579)**

There were no transfers between Level 1 and 2 during the year.

	2010			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets at FVTPL				
Derivative financial assets	–	999	–	999
	–	999	–	999
Financial liabilities at FVTPL				
Derivative financial liabilities	–	(717)	–	(717)
Financial liabilities designated at FVTPL	(293)	–	–	(293)
	(293)	(717)	–	(1,010)
Total	(293)	282	–	(11)

29. Retirement benefit schemes

Defined contribution schemes

On 1 April 2004 the Group introduced a defined contribution pension scheme, the Network Rail Defined Contribution Pension Scheme (NRDCPS). These schemes are offered to all new employees of Network Rail, except those who have the legal right to join the Railway Pension Scheme (RPS). Any employee who wishes to transfer from the Network Rail Section of the RPS to the NRDCPS is entitled to do so.

At 31 March 2011, the NRDCPS had 8,479 members (2010: 9,904) and the average employer contribution rate in the year was 5.3 per cent (2010: 5.2 per cent).

Defined benefit schemes

The principal pension scheme in which the Group participates is the Railway Pension Scheme (RPS), which was established by statutory instrument, commenced on 1 October 1994 and is a funded defined benefit arrangement. The assets and liabilities under the predecessor scheme, the British Rail Pension Scheme (BRPS), were transferred to the RPS on that date. The RPS is an industry-wide scheme for all eligible employees within the railway industry. There are different sections within it for different employers. The assets and liabilities of each section are identified separately from those of the other sections. The Group has its own section, the Network Rail Shared Cost Section (the Network Rail Section). This scheme, the assets of which are held separately from the Group, is contributory and provides pensions related to pay at retirement.

The assets transferred to the RPS from the BRPS on 1 October 1994 were apportioned amongst the various sections of the RPS in accordance with the methods and assumptions specified in The Railways Pensions (Transfer and Miscellaneous Provisions) Order 1994 (the 'Transfer Order') which effected the transfer. The amount credited to the Network Rail Section included a share of the surplus at that time.

Since 1 April 2004, new members can only join the Network Rail Section of the RPS after completing five years' service. Benefits for existing members and employees joining up to and including 31 March 2004 were not affected by the revised eligibility rules of the Network Rail Section. The Group has also announced its decision to cap its contribution to British Railways Additional Superannuation Scheme (BRASS) matching at current levels for existing employees and to dispense with matching for new employees. The Company will continue to match regular contributions but will not increase them in cash terms in the future.

29. Retirement benefit schemes continued

On 1 November 2008 Network Rail launched a third pension scheme – the Career Average Revalued Earnings (CARE) Scheme, which is available to all employees.

Qualified actuaries Towers Watson have valued the schemes on an IAS 19 basis at 31 March 2011 and 31 March 2010.

The total contribution rate payable under the RPS and the CARE scheme is normally split in the proportion 60:40 between the Group and the members. The Group reflects its share of the contribution in the financial statements.

The Group and members pay contributions of 17 per cent (2010: 17 per cent) and 11.4 per cent (2010: 11.4 per cent) of section pay respectively as at 31 March 2011 to RPS. The equivalent rates for the CARE scheme are 10.8 per cent and 7.2 per cent.

If a surplus or deficit arises, the provisions in the rules mean that the Group and members benefit from or pay for this respectively in the proportion 60:40.

	2011 %	2010 %
Key assumptions used:		
Discount rate	**5.60**	5.55
Expected return on equity assets	**7.30**	7.70
Expected return on Government bond assets	**4.40**	4.50
Expected return on Non-Government bond assets	**5.00**	
Expected return on property assets	**6.00**	6.10
Expected rate of price inflation	**3.50**	3.65
Future earnings increases*	**4.50**	4.65
Future pension increases – RPS	**2.50**	3.65
Future pension increases – CARE	**3.50**	3.65

* Inclusive of a promotional salary scale of 0.5 per cent per annum.

Future pension increases in the RPS are assumed to increase with CPI, whereas in the prior year they were assumed to increase with RPI. This change reduced the scheme's defined benefit obligation by £529m. The Group's share of this reduction was £317m.

	2011 Males	2011 Females	2010 Males	2010 Females
Average life expectancy for mortality tables used to determine defined benefit obligations:				
– Member aged 65 now (pension under £8,500 pa or pensionable pay under £30,000 pa)	**19.8**	**21.7**	19.8	21.7
– Member aged 65 now (others)	**21.5**	**22.7**	21.5	22.7
– Member aged 65 in 20 years' time (pension under £8,500 pa or pensionable pay under £30,000 pa)	**22.2**	**23.2**	22.2	23.2
– Member aged 65 in 20 years' time (others)	**23.7**	**24.2**	23.7	24.2

Amounts recognised in income in respect of the Group's pension arrangements are as follows:

	2011 £m	2010 £m
Current service cost – defined contribution (see Note 6)	**17**	16
Current service cost – defined benefit (see Note 6)	**131**	99
Interest cost	**165**	139
Expected return on scheme assets	**(138)**	(99)
	175	155

The current service cost has been included in employee costs, the expected return on scheme assets less interest on liabilities has been included in finance costs.

Amounts recognised in the statements of comprehensive income in respect of the Group's pension arrangement are as follows:

	2011 £m	2010 £m
(Gain)/loss on defined benefit obligation	**(509)**	688
Gain on scheme assets	**(36)**	(396)
Total (gain)/loss recognised in the statements of comprehensive income	**(545)**	292

The cumulative amount of actuarial losses recognised in other comprehensive income was £193m (2010: £738m).

29. Retirement benefit schemes continued

The amount included in the Balance sheet arising from the Group's obligations in respect of its defined benefit schemes is as follows:

	2011 £m	2010 £m
The defined benefit obligation is made up as follows:		
Active members	**(2,793)**	(3,314)
Deferred pensioner members	**(316)**	(360)
Retired members	**(1,218)**	(1,128)
Present value of defined benefit obligation	**(4,327)**	(4,802)
Fair value of scheme assets	**3,519**	3,160
Deficit in the scheme	**(808)**	(1,642)
Company's share (60%) of the scheme deficit recognised in the Balance sheet	**(485)**	(985)

This amount is presented as a non-current liability in the Balance sheet.

Cumulative gains or losses are recognised in equity.

Movements in the present value of retirement benefit scheme obligations (including members' share) in the current year were as follows:

	2011 £m	2010 £m
At 1 April	**(4,802)**	(3,317)
Current service cost including members' share	**(231)**	(175)
Interest cost	**(275)**	(231)
Benefit payments	**131**	68
Actuarial gains and losses	**850**	(1,147)
At 31 March	**(4,327)**	(4,802)

Movements in the present value of fair value of retirement benefit scheme assets (including members' share) in the current year were as follows:

	2011 £m	2010 £m
At 1 April	**3,160**	2,211
Expected return on scheme assets	**230**	164
Actuarial gains and losses	**60**	660
Contributions from scheme members	**70**	67
Contributions from employer	**130**	126
Benefit payments	**(131)**	(68)
At 31 March	**3,519**	3,160

The actual return on scheme assets was £290m (2010: £824m).

The analysis of the scheme assets and the expected rate of return at the Balance sheet date was as follows:

<table>
<tr><th></th><th colspan="2">Expected return</th><th colspan="2">Fair value of assets</th><th colspan="2">Percentage of assets</th></tr>
<tr><th></th><th>2011 %</th><th>2010 %</th><th>2011 £m</th><th>2010 £m</th><th>2011 %</th><th>2010 %</th></tr>
<tr><td>Equity instruments</td><td>7.30</td><td>7.70</td><td>2,795</td><td>2,509</td><td>79.42</td><td>79.40</td></tr>
<tr><td>Debt instruments – Government</td><td>4.40</td><td rowspan="2">4.50</td><td>197</td><td rowspan="2">374</td><td>5.60</td><td rowspan="2">11.84</td></tr>
<tr><td>Debt instruments – Non-government</td><td>5.00</td><td>224</td><td>6.37</td></tr>
<tr><td>Property</td><td>6.00</td><td>6.10</td><td>298</td><td>270</td><td>8.47</td><td>8.54</td></tr>
<tr><td>Other</td><td>3.70</td><td>4.00</td><td>5</td><td>7</td><td>0.14</td><td>0.22</td></tr>
<tr><td></td><td></td><td></td><td>3,519</td><td>3,160</td><td></td><td></td></tr>
</table>

The expected return on assets assumption was determined as the average of the expected returns on the assets held on the accounting date. The rates of return for each class are set out in the table above and were determined as follows:

- equities and property: the rate adopted is consistent with the median assumption used in Towers Watson's Asset Liability Modelling work
- bonds: the overall rate has been set to reflect the yields on the bond holdings
- other assets: this class is mostly made up of cash holdings and the rate adopted reflects current short-term returns on such deposits.

Actuarial assumption sensitivity

The discount rate is set by reference to market conditions at the reporting date, and can vary significantly between periods.

The mortality assumptions used are set by considering the experience of the scheme's members, and by making an allowance for possible future improvements in longevity. Mortality assumptions are difficult to set accurately, and forecasting rates of future mortality improvement is inevitably speculative.

29. Retirement benefit schemes continued

The following table shows the effect of changes in these assumptions upon the defined benefit obligation:

	2011 £m	2010 £m
Discount rate		
Change in defined benefit obligation at year end from a 25 basis points increase	**(194)**	(224)
Change in defined benefit obligation at year end from a 25 basis points decrease	**204**	236
Mortality		
Change in defined benefit obligation from a one year increase in longevity	**106**	144
Change in defined benefit obligation from a one year decrease in longevity	**(111)**	(149)

The history of experience adjustments is as follows:

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Present value of defined benefit obligations	**(4,327)**	(4,802)	(3,317)	(3,572)	(3,424)
Fair value of scheme assets	**3,519**	3,160	2,211	2,955	3,010
Deficit in the scheme	**(808)**	(1,642)	(1,106)	(617)	(414)
Company's share (60%) of the scheme deficit recognised in the Balance sheet	**(485)**	(985)	(664)	(370)	(248)
Experience adjustments on scheme liabilities					
Amount (£m)	**64**	32	151	(114)	(14)
Percentage of scheme liabilities	**1.48%**	0.67%	4.55%	3.19%	0.41%
Experience adjustments on scheme assets					
Amount (£m)	**36**	396	(631)	(222)	52
Percentage of scheme assets	**1.02%**	12.53%	(28.54)%	(7.51)%	1.73%

The estimated amounts of contributions expected to be paid by the Group and members to the scheme during the year ending 31 March 2012 are £133m and £73m, respectively.

30. Related party transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation.

Loans to subsidiaries	2011 £m	2010 £m
Network Rail Holdco Limited	**397**	391
Network Rail (CTRL) Limited	**–**	104
Network Rail Development Limited	**5**	5

Amounts repayable from Network Rail Holdco Limited are long-term and carry interest of from 2.38 per cent to 2.53 per cent (2010: 2.24 per cent to 3.36 per cent).

The amount repayable from Network Rail Development Limited is long-term funding and used to invest in Solum Regeneration Limited. No interest is charged.

Loans from subsidiaries	2011 £m	2010 £m
Network Rail Infrastructure Finance PLC	**24,349**	22,632

The weighted average interest rate on the borrowings from Network Rail Infrastructure Finance PLC is 5.45 per cent (2010: 4.98 per cent).

The Company considers its key management personnel to be its Directors. Details of their remuneration can be found in the Directors' remuneration report on pages 30 to 57.

The Company's ultimate parent company and controlling entity is Network Rail Limited, a company limited by guarantee without shares. The Company's immediate parent company is Network Rail Holdco Limited. Both parent companies are incorporated in Great Britain and registered in England and Wales. The largest group of undertakings of which the Company is a member and for which Group accounts are drawn up is Network Rail Limited. Copies of the parent companies' financial statements can be obtained by contacting the Company Secretary at Kings Place, 90 York Way, London N1 9AG.

Company information

Calendar 2011/12

31 March 2011	Year end
9 June 2011	Preliminary results announcement for full year to 31 March 2011
21 July 2011	Annual General Meeting of Network Rail Limited
November 2011	Results for half-year announcement to 30 September 2011
31 March 2012	Year end

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