

NETWORK RAIL INFRASTRUCTURE LIMITED

**Regulatory financial statements
for the year ended
31 March 2004**

NETWORK RAIL INFRASTRUCTURE LIMITED

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NETWORK RAIL INFRASTRUCTURE LIMITED

DIRECTORS' REVIEW

The directors of Network Rail Infrastructure Limited ("the Company") are pleased to present the regulatory financial statements for the year ended 31 March 2004. The basis of preparation of these financial statements is significantly different to the basis used to prepare the statutory financial statements and is explained in detail below and in the accounting policies note.

Regulatory financial performance

The actual net regulatory asset base ("RAB") operating return for the year ended 31 March 2004 was £899million (2003 - £557million) compared with that in the Periodic Review of Railtrack's Access Charges: Final Conclusions published by the Rail Regulator in October 2000 ("the 2000 regulatory determination") of £587million. The Company incurred additional renewals, maintenance, operating expenditure, and performance penalties of £2,785million (2003 - £1,865million) in the year against the 2000 regulatory determination. However as a result of the Rail Regulator's statement of 27 June 2002 in respect of the acquisition of Railtrack PLC by Network Rail, and the subsequent interim review, this additional spend has been included as an increase in RAB and treated as regulatory income in the regulatory financial statements.

The RAB operating return reflects an 12.3% return on the average RAB, compared to the Rail Regulator's expected return of 8.0%. The increased return is as a result of additional property profits of £12million (2003 - £12 million) (which are subject to clawback under the property allowance scheme) and various incentives (in particular for broken rails), set by the regulator, which total £466million (2003 - £34million) offset by a net reduction in fixed and single till income of £184million

The total operating return for the year, which includes income and expenditure on assets that are outside of the regulatory asset base, was £1,590million (2003 - £886 million). This compares to a reported operating loss in the Company's statutory accounts for the year ended 31 March 2004 of £758million (2003 - profit of £80million). A full reconciliation of the differences between these results is provided in Appendix A.

Regulatory financial position

The regulatory financial position of the Company shows a total regulated asset valuation of £16,728million (2003 - £12,442 million) compared with the 2000 regulatory determination of £9,673million (2003 - £9,061 million). The difference between the totals mainly reflects the RAB adjustments in accordance with the principles established in the statement made on 27 June 2002 and the Regulator's conclusions on the interim review which were published in December 2003. This difference is, therefore, agreed with the Office of Rail Regulation. Reasons for the additional spend are given below.

The 'logged up' valuation of the RAB at 31 March 2004, before the adjustments described above, is £7,557million (2003 - £7,017million). This is £36million (2003 - £43million) lower than the 2000 regulatory determination of £7,593million (2003 - £7,060 million). The net total regulatory assets of Network Rail Infrastructure Limited at 31 March 2004 were £4,388million (2003 - £2,673million) compared with net assets reported in the statutory financial statements of £3,592million (2003 - £1,748million). A net assets reconciliation is provided in Appendix B to these financial statements, with a reconciliation of the RAB and ring fenced assets to statutory fixed assets in Appendix C to these financial statements.

Material variations from the 2000 regulatory determination

Income

The main variance from the 2000 regulatory determination in terms of income is created by the impact of Schedule 8 and Schedule 4 performance costs which have reduced franchise access income by £333million (2003 - £381million). This is a reflection of further work undertaken to regain control of the network post-Hatfield, outlined in more detail below. The overall income variance compared with the determination, after taking into account incentives and overspend adjustment is a positive variance of £294million (2003 - negative variance of £17million).

Expenditure

The overall expenditure variance, before taking account of the Rail Regulator's statement, was a negative variance of £2,431million (2003 - £1,466million). The most significant factors that have caused this expenditure variance are:

- **Track renewals and maintenance** have been subject to a complete review since Hatfield as we have sought to regain engineering control of the network. Continuing key drivers for the increase in track renewals

DIRECTORS' REVIEW

expenditure include an improved understanding of the condition of track assets and new information on the rate of degradation of track assets (including the emergence of rolling contact fatigue). The increased maintenance costs are predominately as a result of additional track maintenance and inspection activities (including rail grinding, S&C hand grinding, train-borne ultrasonic inspections and the installation of new lubricators) that had not been anticipated at the time of the periodic review.

- **Other costs**, which comprise staff costs and other production and management costs have risen as a result of various items. The Company's functional reorganisation has led to exceptional transitional costs which will deliver benefits in the short term. The decision to bring maintenance in-house has increased employee numbers as IMC employees transfer across to join the Company. The increase in employee numbers of 13% is matched by the increase in costs.

RAB

Adjustments for amounts spent in excess of the 2000 regulatory determination have been incorporated into the RAB as an accumulated adjustment. These adjustments total some £3,238million (2003 - £2,092million) for the year and cumulatively total £6,345million (2003 - £3,107million). The reasons for the additional spend are outlined above.

Basis of preparation

Regulatory financial statements are required to be prepared by Network Rail Infrastructure Limited under the terms of its Network Licence dated 31 March 1994, as amended on 2 July 2004, ("the Licence"). This is a requirement which came into effect for Regulatory Control Period 2 ("CP2"), commencing on 1 April 2001. The form of the regulatory financial statements is specified in Condition 22 of the Licence and the statements must be prepared in accordance with detailed Regulatory Accounting Guidelines issued by the Regulator in accordance with Condition 22.

The regulatory financial statements are prepared on a basis which differs significantly from United Kingdom generally accepted accounting principles ("UK GAAP"). Network Rail Infrastructure Limited's statutory accounts for the year ended 31 March 2004 have been filed with the Registrar of Companies and were prepared in accordance with UK GAAP. Appendix A includes a reconciliation of the operating profit in the statutory accounts to the total operating return reported in the regulatory financial statements.

The detailed regulatory accounting policies adopted are set out after the statement of regulatory financial position.

Interim Review

The Interim Review of Track Access Charges was concluded in December 2003, with the Regulator determining Network Rail's income for the five years from 1 April 2004 at £22.2bn. This review did not become effective until 1 April 2004 and, as such, comparative regulatory determination figures in these financial statements are those from the 2000 regulatory determination. The successful conclusion of the Review was very welcome, giving Network Rail certainty and stability regarding its future income and putting the Company on a secure financial footing for the future. It also requires the Company to deliver an unprecedented 31% improvement in efficiency over the next five years alongside significant increases in train punctuality.

By order of the board



John Armitt



Ron Henderson

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing regulatory financial statements in accordance with Condition 22 of the Network Licence dated 31 March 1994, as amended on 2 July 2004.

In preparing those regulatory financial statements, the directors are required by Condition 22 to:

- prepare the regulatory financial statements in respect of each year ended 31 March and (save as otherwise provided in Condition 22 or the Regulatory Accounting Guidelines) thereafter on a consistent basis in respect of each succeeding year;
- prepare the regulatory financial statements such that, insofar as reasonably practical, the definition of items in primary statements; the valuation of assets and liabilities; the treatment of income and expenditure as capital or revenue; adjustments in respect of the provision, utilisation, depreciation and amortisation of assets and liabilities; and any other relevant accounting policies shall be consistent with:
 - (i) the Regulator's valuation of the Regulatory Asset Base for the purpose of determining access charges; and
 - (ii) the Determination Assumptions for the corresponding period as defined in Condition 22;(and so that where the presentation of an item in the primary statements departs from the basis for the Regulatory Asset Base or the Determination Assumptions, a reconciliation shall be included by way of a note);
- include, as a primary statement, a statement of regulatory financial performance comparing income, expenditure, profits and losses for the period with the Determination Assumptions;
- include all details reasonably necessary to reconcile the primary statements with the annual statutory accounts for the same period.

In addition the directors are responsible for selecting suitable accounting policies where these are not directed by Regulatory Accounting Guidelines and for making judgements and estimates that are reasonable and prudent.

The board of directors is also required to approve formally the regulatory financial statements by signing Part B – Statement of Regulatory Financial Position of the regulatory financial statements.

In accordance with the Regulatory Accounting Guidelines the statutory financial statements are included as an attachment to these regulatory financial statements to enable a comparison. It should be noted that these statutory financial statements, which do not form a part of the regulatory financial statements, are covered by a separate audit engagement and opinion and are included for information only.

INDEPENDENT AUDITORS' REPORT TO NETWORK RAIL INFRASTRUCTURE LIMITED AND THE OFFICE OF THE RAIL REGULATOR

In accordance with our terms of engagement dated 19 May 2004, we have audited the regulatory financial statements of Network Rail Infrastructure Limited for the year ended 31 March 2004 which comprise the statement of regulatory financial performance, the statement of regulatory financial position, the statement of accounting policies, the related statements 1 to 8 and the related appendices A to D.

The regulatory financial statements are separate from the statutory financial statements and have been prepared under the accounting policies set out therein which differ significantly from United Kingdom generally accepted accounting principles ("UK GAAP"). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a Company as shown in the financial statements prepared in accordance with the Companies Act 1985.

Respective responsibilities of directors and auditors

The nature, form and content of the regulatory financial statements are determined by the requirements of the Office of the Rail Regulator ("ORR"). It is not appropriate for the auditors or the directors to assess whether the nature of the information being reported upon is suitable or appropriate for the ORR's purposes. Accordingly, we make no such assessment.

As described in the statement of directors' responsibilities, the Company's directors are responsible for the preparation of the regulatory financial statements in accordance with Condition 22 of Network Rail Infrastructure Limited's network licence dated 31 March 1994 as amended on 2 July 2004 ("Condition 22") and the Regulatory Accounting Guidelines issued on 11 July 2003 in accordance with Condition 22 and subsequent additional guidance provided by the Office of the Rail Regulator ("the Regulatory Accounting Guidelines"). Our responsibility, as set out in our terms of engagement, is to audit the regulatory financial statements in accordance with those terms, relevant United Kingdom auditing standards, and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' and Condition 22.

We report to you our opinion as to whether the regulatory financial statements present fairly the regulatory financial performance of Network Rail Infrastructure Limited for the year ended 31 March 2004 and the regulatory financial position as at that date in accordance with the requirements of Condition 22 and the Regulatory Accounting Guidelines and have been prepared in accordance with those same requirements. We also report to you if, in our opinion, the Company has not kept proper accounting records, the regulatory financial statements are not in agreement with the underlying accounting records and regulatory returns, or if we have not received all the information and explanations we require for our audit.

We read the Directors' Review and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the regulatory financial statements.

Our report is made solely to the Company and the ORR, in accordance with paragraph 9 of Condition 22. Our audit work was undertaken so that we might state to the Company and the ORR those matters we are required to state to them by paragraph 9 of Condition 22 and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the ORR for our audit work, for this report or for the opinions we have formed.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the regulatory financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the regulatory financial statements. It does not include an assessment of whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by the Regulatory Accounting Guidelines. Where the Regulatory Accounting Guidelines do not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the regulatory financial statements are consistent with those used in the preparation of the statutory financial statements of Network Rail Infrastructure Limited.

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

Our opinion on the regulatory financial statements is separate from our opinion on the statutory financial statements of the Company on which we reported on 2 June 2004, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory" audit) was made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a Statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

Opinion

In our opinion the regulatory financial statements present fairly the regulatory financial performance of Network Rail Infrastructure Limited for the year ended 31 March 2004 and the regulatory financial position as at that date, and have been prepared, in accordance with the requirements of Condition 22 and the Regulatory Accounting Guidelines.



Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London

30 July 2004

NETWORK RAIL INFRASTRUCTURE LIMITED

PART A – STATEMENT OF REGULATORY FINANCIAL PERFORMANCE Year ended 31 March 2004

	Notes	Actual performance 2003/04 £m	2000 ORR Determination 2003/04 £m	Difference 2003/04 £m	Cumulative Difference in 2003/04 prices £m
INCOME					
Franchise access	S3	1,581	1,958	(377)	(1,329)
Other single till	S3	406	567	(161)	(362)
Property income	S3/S6	256	244	12	65
Total revenue and incentive adjustment accrued and overspend allowance		955	135	820	1,976
Grants adjustment		1,014	1,014	-	-
Profiling adjustment accrued	S1	47	47	-	-
Total		4,259	3,965	294	350
EXPENDITURE					
Renewals	S4	(3,070)	(1,760)	(1,310)	(1,991)
Maintenance	S4	(1,409)	(683)	(726)	(1,503)
Opex own costs	S4	(1,060)	(596)	(464)	(1,175)
Joint industry costs	S4	(267)	(336)	69	142
Total expenditure adjustment for overspend allowance	S1	2,431	-	2,431	4,581
Total		(3,375)	(3,375)	-	54
RAB ADJUSTMENTS					
RAB depreciation		-	(3)	3	4
Capitalised financing		15	-	15	42
Total		15	(3)	18	46
NET RAB OPERATING RETURN		899	587	312	450
CAPITALISED FINANCING OF REGULATORY ACCRUALS AND GRANTS					
		497			
NON-RAB ACTIVITIES					
Thameslink 2000 control period 1 expenditure	S1	119			
Capitalised financing		75			
Working capital adjustments		-			
Return on ring-fenced activities		194			
TOTAL OPERATING RETURN		1,590			
INTEREST					
Interest		(424)			
Movement in market value of debt		(61)			
Real interest cost		(485)			
Inflation adjustments to RAB and other items		322			
Tax		-			
TOTAL RETURN BEFORE ADJUSTMENTS		1,427			
Difference between actual 03/04 outturn and interim review determination		288			
TOTAL RETURN AFTER ADJUSTMENTS		1,715			

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PART B – STATEMENT OF REGULATORY FINANCIAL POSITION

Year ended 31 March 2004

	Notes	Actual performance 2003/04 £m	2000 ORR Determination 2003/04 £m	Difference 2003/04 £m
ASSET BASE ANALYSIS				
Opening RAB	S1	7,173	7,219	(46)
Value added through enhancements	S1	384	374	10
Subtotal		<u>7,557</u>	<u>7,593</u>	<u>(36)</u>
RAB incentive adjustments accrued	S1	595	459	136
RAB revenue adjustments accrued	S1	1	-	1
Cumulative allowance for overspend	S1	6,345	-	6,345
Retiming of SRA grants and deferred income	S1	1,157	671	486
Thameslink 2000 control period 1 expenditure previously written off	S1	125	-	125
Profiling adjustment to income	S1	948	950	(2)
Total RAB valuation		<u>16,728</u>	<u>9,673</u>	<u>7,055</u>
Non-RAB enhancements accrued	S1	<u>1,174</u>		
		17,902		
Difference between actual 03/04 outturn and interim review determination		<u>288</u>		
1 April 2004 RAB		<u>18,190</u>		
Working capital		(1,444)		
Working capital amount included in initial RAB		<u>504</u>		
Net operating assets		17,250		
Net debt		(12,862)		
Tax balances – Deferred taxation		-		
– Corporation tax		-		
Net total regulatory assets		<u>4,388</u>		
Average rolling RAB valuation		7,305		
NET RAB OPERATING RETURN ON AVERAGE RAB		<u>12.3%</u>	<u>8.0%</u>	<u>4.3%</u>

Approved by order of the Board of Directors on 30 July 2004

Signed on behalf of the Board of Directors



John Armitt



Ron Henderson

NETWORK RAIL INFRASTRUCTURE LIMITED

STATEMENT OF ACCOUNTING POLICIES

Year ended 31 March 2004

Regulatory financial statements are required to be prepared by Network Rail Infrastructure Limited under the terms of its Network Licence dated 31 March 1994, as amended on 2 July 2004, ("the Licence"). This is a requirement which came into effect for Regulatory Control Period 2, commencing on 1 April 2001. The form of the regulatory financial statements is specified in Condition 22 of the Licence and the statements must be prepared in accordance with detailed Regulatory Accounting Guidelines issued by the Regulator in accordance with Condition 22.

The regulatory financial statements are prepared on a basis which differs significantly from United Kingdom generally accepted accounting principles ("UK GAAP") and do not constitute statutory accounts within the meaning of Section 240 of the Companies Act 1985. Network Rail Infrastructure Limited's statutory accounts for the year ended 31 March 2004 have been filed with the Registrar of Companies and were prepared in accordance with UK GAAP. The report of the auditors on the accounts filed with the Registrar of Companies was unqualified and did not contain a statement under Section 237(2) or (3) of the Companies Act 1985. Appendix A includes a reconciliation of the operating profit in the statutory accounts to the total operating return reported in the regulatory financial statements.

Going concern basis

The Company's statutory financial statements were prepared on the going concern basis, which is a fundamental accounting concept under UK GAAP. The Regulatory Accounting Guidelines do not specifically state that the going concern basis should be applied in preparing the regulatory financial statements. However where, in the absence of specific guidance in the Regulatory Accounting Guidelines, accounting policies have been based on those used in the statutory financial statements, and accordingly the going concern basis has been applied.

Comparative determination numbers

The Interim Review of Track Access Charges was concluded in December 2003, with the Regulator determining Network Rail's income for the five years from 1 April 2004 at £22.2bn. This review did not become effective until 1 April 2004 and, as such, comparative regulatory determination figures in these financial statements are those from the 2000 regulatory determination.

Accounting policies

(a) Accounting convention and basis of consolidation

The regulatory financial statements have been prepared in accordance with the Regulatory Accounting Guidelines issued by the Rail Regulator in accordance with Condition 22 of the Network Licence and additional guidance provided by the Office of the Rail Regulator ("RAGs"). The regulatory financial statements include regulatory valuations that are adjusted for the effects of inflation and follow a financial capital maintenance approach under a discounted present value methodology. Accordingly items in the accounts are included on a current value or value in use basis.

The financial statements are prepared for Network Rail Infrastructure Limited only, as the licence holder, therefore excluding any results or assets of Network Rail Infrastructure Limited's subsidiaries included in the consolidated Network Rail Infrastructure Limited statutory financial statements.

(b) Income and expenditure

Income and expenditure in respect of which the Rail Regulator made an assumption in the October 2000 periodic review ("Determination Assumptions") is accounted for and classified on a consistent basis with those Determination Assumptions. In particular, income, renewals and maintenance spend are presented by asset category in disclosure statements 3 and 4; where there is a need to apply an allocative rule in order to derive this information this rule is clearly stated.

(c) Performance regimes

Supplements to the access charges and bonuses receivable from, less penalties payable to, customers are included in income. Additional contract amounts and bonuses payable to, less penalties receivable from suppliers and the Rail Regulator are included in expenditure.

STATEMENT OF ACCOUNTING POLICIES

Year ended 31 March 2004

(d) Segmental analysis, cost allocation and transfer pricing

Cost attribution and allocation policies relating to other transactions and arrangements are allocated in relation to the way resources are consumed. Direct costs are allocated in the way in which they are incurred and indirect costs are allocated using a methodology having regard to the materiality of the allocations.

(e) Asset valuation

The Rail Regulator's valuation of the RAB is based on a rolled forward initial market value assessment from 1 April 2001. The regulatory balance sheet therefore includes the value of net investment that is expected to be included in the Rail Regulator's valuation at the next or subsequent periodic reviews.

The item in the balance sheet, the RAB account, is the accounting valuation of the RAB using a methodology consistent with that used by the Rail Regulator in his Determination Assumptions. It does not represent the Rail Regulator's valuation but is an estimate of the economic value of past investment and activities that will be remunerated through allowed returns on the RAB in future years.

Adjustments to the RAB account are made in accordance with the methodology used in the Rail Regulator's 2000 periodic review subject to the following:

- the RAB account is increased by eligible (or potentially eligible) enhancement expenditure as incurred;
- provision is made for the depreciation taken into account in setting single till charges (depreciation assumed as part of the Determination Assumptions is set out in Part IV of the RAGs);
- provisions reducing the RAB account have been made in respect of ineligible enhancement expenditure and attributable financing costs. For instance costs which either:
 - (a) the Rail Regulator has formally indicated will not be remunerated through allowed returns on the RAB in future years; or
 - (b) Network Rail Infrastructure Limited has decided are ineligible and will not be put forward for logging up into the RAB;
- adjustments are included which increase the RAB account in respect of amounts reasonably certain to be allowed in excess of eligible enhancement expenditure and attributable financing costs incurred, for example as a result of savings in enhancement expenditure;
- the RAB account is also increased by financing costs to the extent that they are expected to be recognised and they are calculated to show an 8% rate of return on the arithmetic average of relevant opening and closing balances;
- the RAB is increased to reflect the effect of general inflation between the start and end of the year in respect of opening balances (the movement in the RPI from March to March) and the effect of general inflation between the transactions in the year and the end of the year (the movement from the average RPI in April to March to the RPI in March at the end of the year).

The same process is followed in calculating the ring-fenced asset base, although this is not regulated. Additions are logged up where they are considered to be covered by anticipated remuneration. Depreciation is provided against ring-fenced assets once capitalised.

(f) Adjustments to be carried forward to 2004 RAB

In his 2000 periodic review the Rail Regulator made provision for a number of adjustments to the RAB in 2004 in respect of items other than enhancements. Further adjustments were anticipated in the SRA agreement with Railtrack of 2 April 2001 and in paragraphs 57 to 62 of the Regulator's statement published on 27 June 2002 in relation to the acquisition of Railtrack PLC (now Network Rail Infrastructure Limited) by Network Rail Limited. These relate to:

- additional expenditure in excess of the original determination incurred before April 2004; and
- reprofiling of SRA grants as agreed between Network Rail and the SRA.

The accrued present value of future adjustments to the RAB has been included in the statement of regulatory financial position, using a real discount rate of 8%. The unwinding of discounts is credited to the statement of regulatory financial performance as part of the return before interest and taxation (operating return).

STATEMENT OF ACCOUNTING POLICIES

Year ended 31 March 2004

(g) Profiling adjustment to income

The 2000 periodic review provided for a profile of revenue over the control period which was different from the profile of costs. In order to report meaningful returns that are comparable with the rate of return provided for in the determination, Part IV of the RAGs explains the adjustments that are made to revenues and included in the balance sheet over the control period.

(h) Grants

Timing differences between the payment of revenue grants and the costs of management and provision of assets to which the grants relate are accounted for through the regulatory balance sheet and rolled forward with adjustments as appropriate for the effects of inflation and the capitalisation of financing.

(i) Other assets and liabilities

Other balance sheet assets and liabilities are included in the accounts on a current value or value in use basis. To this extent the carrying value of net debt is stated at market value where this value differs materially from the historic book value.

Stocks and work-in-progress, other than on long term contracts, are stated at the lower of cost and net realisable value. Cost includes materials, direct labour and production overheads appropriate to the relevant stage of production. Net realisable value is based on estimated selling price less all further costs to completion and all relevant marketing, selling and distribution costs.

(j) Pension costs

The expected cost of providing pensions, as calculated periodically by professionally qualified actuaries, is charged so as to spread the cost over the service lives of employees in the scheme in such a way that the pension cost is a substantially level percentage of current and expected future pensionable payroll. Differences between the amount charged as costs for the year and payments made to schemes are treated as asset or liabilities in the balance sheet.

(k) Financial instruments

The Company uses derivative financial instruments to reduce exposure to foreign exchange risk and interest rate movements. The Company does not hold or issue derivative financial instruments for speculative purposes.

For a forward foreign exchange contract to be treated as a hedge the instrument must be related to actual foreign currency assets or liabilities or to a probable commitment. It must involve the same currency or similar currencies as the hedged item and must also reduce the risk of foreign currency exchange movements on the Group's operations. Gains and losses arising on these contracts are deferred and recognised in the profit and loss account only when the hedged transaction has itself been reflected in the Group's financial statements.

For an interest rate or cross currency swap to be treated as a hedge the instrument must be related to actual assets or liabilities or a probable commitment and must change the nature of the interest rate by converting a fixed rate to a variable rate or vice versa. Interest differentials under these swaps are recognised by adjusting net interest payable over the period of these contracts.

If an instrument ceases to be accounted for as a hedge, for example because the underlying hedge position is eliminated, the instrument is marked to market and any resulting profit and loss recognised at that time.

Monetary assets and liabilities expressed in foreign currencies are translated into sterling at rates of exchange ruling at the end of the financial year. Individual transactions denominated in foreign currencies are translated into sterling at the exchange rates ruling on the dates payment takes place, unless related or matching forward foreign exchange contracts have been entered into, then the rates specified in the relevant contracts are used. All exchange differences are included in the profit and loss account.

Discount of principal and fees associated with the issue of debt instruments are accounted for as a reduction in the balance outstanding of the debt and are amortised over the life of the debt. The amortisation charge is included within interest payable.

STATEMENT OF ACCOUNTING POLICIES

Year ended 31 March 2004

(l) Property clawback

Train operating companies are entitled to a share of any property gains and income (above certain thresholds). The total property clawback payable in respect of the year ended 31 March 2004 is calculated in Statement 6.

(m) Taxation

Corporation tax

The corporation tax credit or charge for the year, taking into account adjustments to prior year estimates, is included in the regulatory financial statements, consistent with the tax shown in the statutory financial statements for the year.

Deferred taxation

Prudent provision is made for deferred tax assets and liabilities arising from timing differences between the recognition of gains and losses in the regulatory financial statements and their recognition in a tax computation. The methodology as set out in the revised Regulatory Accounting Guidelines (published on 11 July 2003) is as follows:

- consistent with the value in use basis, the deferred tax position should be calculated as the difference between the discounted value of pre-tax cash flows attributable to net assets currently held by the Company, using an appropriate pre-tax discount rate (namely the value in use valuation), and the discounted value of the corresponding post-tax cash flows but discounted at an appropriate post-tax discount rate;
- the balance sheet value of operating net assets can normally be reasonably assumed to be recoverable as revenues in the form of an annuity unless the Regulator indicates otherwise;
- tax cash flows on the assumed revenues for this purpose should be determined after taking into account all future tax allowances that are available on account of transactions occurring on or before the balance sheet date but disregarding all other tax allowances except to the extent that they would be available on account of the assumed revenues. (Tax allowances are available in respect of transactions included in the Statutory Accounts as adjusted in accordance with legislation and practice);
- a post-tax, pre-debt discount rate consistent with the cost of capital assessment (namely a post-tax return of 5.6% would be consistent with a pre-tax return of 8.0% and tax of 30%) should be used to evaluate the resulting post-tax cash flows;
- the deferred tax assessment should be made separately for the operating component of the balance sheet, i.e. excluding working capital balances (operating debtors and creditors);
- as no substantial tax timing differences are expected in respect of income and costs relating to working capital balances and financing balances, any deferred tax relating to these components may be disregarded unless it is considered likely that they could materially affect any deferred tax provision;
- full provision should be made on the balance sheet in respect of any deferred tax liability but any deferred tax assets that cannot be recovered against deferred tax liabilities may be disregarded on account of prudence; and
- if deferred tax is not provided for on account of it not being prudent to recognise a deferred tax asset, the Company should disclose in a note to the regulatory financial statements the post-tax discount rate that would be consistent with the operating component (excluding working capital) of deferred tax having a zero value and the effective rate of tax on operating returns that is implied by that rate.

The provision may be significantly different from the provision calculated under UK GAAP due to the different treatments of gains and losses in the regulatory financial statements.

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STATEMENT 1: RAB ADJUSTMENTS AND ACCRUALS

Year ended 31 March 2004

Calculation of RAB

	Opening value £m	Receipt of grant payments £m	Movements in the year			Inflation £m	Total £m
			Income adjustments £m	Expenditure adjustments £m	Capitalised financing £m		
Opening RAB	7,017	-	-	-	-	156	7,173
Incentive and other non-enhancement adjustments							
Volume incentive (freight and passenger)	66	-	77	-	8	2	153
Capacity charge shortfall	4	-	-	-	-	-	4
Broken rails adjustment	39	-	377	-	18	4	438
Project development costs	-	-	-	-	-	-	-
Land disposal compensation	-	-	-	-	-	-	-
Adjustment to reflect 00/01 performance	-	-	-	-	-	-	-
Possession compensation	-	-	-	-	-	-	-
Cost of meeting additional obligations	-	-	-	-	-	-	-
Railway safety charge (difference)	1	-	-	-	-	-	1
Allowance for overspend (including project gains and losses)	3,107	-	354	2,431	357	96	6,345
Thameslink 2000 control period 1 expenditure previously written off (per December 2003 final conclusions)	-	-	-	119	5	1	125
Retiming of SRA grants and deferred income	1,393	(1,448)	1,161*	-	42	9	1,157
Profiling adjustments to income	815	-	47	-	67	19	948
Enhancements							
Enhancements and other expenditure in the year (Statement 2)	-	-	-	366	15	3	384
Ring fenced enhancements	793	-	-	285	75	21	1,174
Adjustment to be incorporated in 2004 RAB	13,235	(1,448)	2,016	3,201	587	311	17,902
Closing RAB							
Difference between actual 03/04 outturn and interim review determination							288
1 April 2004 RAB							18,190

* - Income adjustment of £1,161million consists of retiming of SRA grants of £1,014million, deferred income adjustment of £135million and freight grant adjustment of £12million.

NETWORK RAIL INFRASTRUCTURE LIMITED

STATEMENT 1: RAB ADJUSTMENTS AND ACCRUALS

Year ended 31 March 2004

Annual Adjustments	Analysis of value by year of movement, current prices				Total £m
	Value at 1 April 2001 £m	Adjustments in 2001/02 £m	Adjustments in 2002/03 £m	Adjustments in 2003/04 £m	
Opening RAB	5,878	519	620	156	7,173
Incentive and other non-enhancement adjustments					
Volume incentive (freight and passenger)	-	48	18	87	153
Capacity charge shortfall	-	4	-	-	4
Broken rails adjustment	-	17	22	399	438
Project development costs	-	-	-	-	-
Land disposal compensation	-	-	-	-	-
Adjustment to reflect 00/01 performance	-	-	-	-	-
Possession compensation	-	-	-	-	-
Cost of meeting additional obligations	-	-	-	-	-
Railway safety charge (difference)	-	1	-	-	1
Allowance for overspend (including project gains and losses)	-	1,015	2,092	3,238	6,345
Thameslink 2000 control period 1 expenditure previously written off (per December 2003 final conclusions)	-	-	-	125	125
Retiming of SRA grants and deferred income	-	633	760	(236)	1,157
Profiling adjustments to income	-	478	337	133	948
Enhancements					
Enhancements and other expenditure in the year (Statement 2)	-	-	-	384	384
Ring fenced enhancements	-	538	255	381	1,174
Adjustment to be incorporated in 2004 RAB	5,878	3,253	4,104	4,667	17,902
Closing RAB					
Difference between actual 03/04 outturn and interim review determination					288
1 April 2004 RAB					18,190

NETWORK RAIL INFRASTRUCTURE LIMITED

STATEMENT 2: DETAILED ANALYSIS OF ENHANCEMENT SPEND Year ended 31 March 2004

	Movement in the year			2000 ORR determin- ation for RAB £m	Difference £m
	RAB £m	Ring-fenced £m	Total £m		
Analysis of enhancements					
Train protection scheme	58	-	58	119	(61)
Platform stepping	-	-	-	16	(16)
Track and signalling IOS schemes	6	-	6	135	(129)
Performance related	-	-	-	11	(11)
Waterloo – Fawkham Junction	7	-	7	4	3
ECML Phase 1	-	-	-	-	-
Stations IOS	1	-	1	89	(88)
Total	72	-	72	374	(302)
Other enhancement allowances					
Project gains and losses	-	-	-	-	-
Stations and depots renewal	35	-	35	-	35
Other enhancement projects	259	285	544	1,903	(1,359)
Total	294	285	579	1,903	(1,324)
Total enhancements	366	285	651	2,277	(1,626)

Cumulative analysis

	Expenditure £m	2000 ORR determination £m	Cumulative difference in current (2003/04) prices £m
RAB	<hr/>	<hr/>	<hr/>
	1,269	4,795	(3,526)
Ring-fenced	<hr/>		
	1,078		
Total	<hr/>		
	2,347		
	<hr/>		

NETWORK RAIL INFRASTRUCTURE LIMITED

STATEMENT 3: INCOME STATEMENT

Year ended 31 March 2004

	Actual performance 2003/04 £m	2000 ORR Determination 2003/04 £m	Difference 2003/04 £m	Cumulative difference in 2003/04 prices £m
FRANCHISE ACCESS INCOME				
FIXED CHARGES				
Railway Safety charge	40	34	6	3
Base charge	1,589	1,622	(33)	(137)
Schedule 4 supplements	46	46	-	(4)
Schedule 8 supplements	2	2	-	3
Other	4	-	4	5
TOTAL FIXED CHARGES	<u>1,681</u>	<u>1,704</u>	<u>(23)</u>	<u>(130)</u>
VARIABLE CHARGES				
Usage charge	176	162	14	28
Capacity charge	4	-	4	5
EC4T	116	155	(39)	(77)
Schedule 4 compensation	(53)	(49)	(4)	(34)
Schedule 8 penalty	(343)	(14)	(329)	(1,121)
TOTAL VARIABLE CHARGE	<u>(100)</u>	<u>254</u>	<u>(354)</u>	<u>(1,199)</u>
TOTAL FRANCHISE ACCESS INCOME	<u>1,581</u>	<u>1,958</u>	<u>(377)</u>	<u>(1,329)</u>
OTHER INCOME				
Freight access	68	194	(126)	(350)
Open access	20	53	(33)	(25)
Station charges	274	277	(3)	6
Depot charges	44	41	3	8
Other	-	2	(2)	(1)
TOTAL OTHER SINGLE TILL	<u>406</u>	<u>567</u>	<u>(161)</u>	<u>(362)</u>
PROPERTY INCOME	<u>256</u>	<u>244</u>	<u>12</u>	<u>65</u>
TOTAL OTHER INCOME	<u>662</u>	<u>811</u>	<u>(149)</u>	<u>(297)</u>

Ring fenced revenues are immaterial and have been included in fixed access charges.

NETWORK RAIL INFRASTRUCTURE LIMITED

STATEMENT 4: EXPENDITURE STATEMENT

Year ended 31 March 2004

	Actual performance 2003/04 £m	2000 ORR Determination 2003/04 £m	Difference 2003/04 £m	Cumulative difference in 2003/04 prices £m
RENEWALS				
Track	1,237	492	(745)	(1,460)
Train control	870	789	(81)	364
Electrification	220	95	(125)	(200)
Structures	357	197	(160)	(392)
Station and depots	90	99	9	28
IS expenditure	90	64	(26)	(67)
Plant and machinery	187	20	(167)	(244)
Other	19	4	(15)	(20)
TOTAL RENEWALS	3,070	1,760	(1,310)	(1,991)
MAINTENANCE				
Track	775	376	(399)	(831)
Train control	369	179	(190)	(388)
Electrification	67	33	(34)	(73)
Other	198	95	(103)	(211)
TOTAL MAINTENANCE	1,409*	683	(726)	(1,503)
OPEX OWN COSTS				
Signalling staff costs	269	143	(126)	(295)
Other staff costs	378	237	(141)	(244)
Other production and management costs	413	216	(197)	(636)
TOTAL OWN COSTS	1,060	596	(464)	(1,175)
JOINT INDUSTRY COSTS				
Railway Safety costs	40	34	(6)	(3)
EC4T	81	135	54	106
Cumulo rates	102	160	58	74
BT police	37	-	(37)	(37)
ORR licence fee	7	7	-	2
TOTAL JOINT INDUSTRY	267	336	69	142

* Total maintenance includes exceptional items and reactive maintenance reallocation. Maintenance costs excluding these items total £1,245million.

In accordance with paragraph 2.2 of the Regulatory Accounting Guidelines, the above maintenance expenditure is allocated to asset categories using the same pro-rata basis as that used in the Determination.

NETWORK RAIL INFRASTRUCTURE LIMITED

STATEMENT 5: RENEWALS COSTS BY ASSET CATEGORY

Year ended 31 March 2004

	Actual performance 2003/04 £m	2000 ORR Determination 2003/04 £m	Difference 2003/04 £m	Cumulative difference in 2003/04 prices £m
RENEWALS				
Non WCRM				
Track	653	303	(350)	(940)
Train control	433	417	(16)	166
Electrification	29	52	23	64
Structures	280	171	(109)	(331)
Stations and depots	90	99	9	28
IT	90	64	(26)	(67)
Plant and machinery	152	20	(132)	(206)
Other	17	4	(13)	(21)
Total non WCRM	1,744	1,130	(614)	(1,307)
WCRM				
Track	584	189	(395)	(520)
Train control	437	372	(65)	198
Electrification	191	43	(148)	(264)
Structures	77	26	(51)	(61)
Stations and depots	-	-	-	-
IT	-	-	-	-
Plant and machinery	35	-	(35)	(38)
Other	2	-	(2)	1
Total WCRM	1,326	630	(696)	(684)

NETWORK RAIL INFRASTRUCTURE LIMITED

STATEMENT 6: PROPERTY ALLOWANCE SCHEME (PAS)

Year ended 31 March 2004

	2003/04 £m	Cumulative to date (in 2003/04 prices) £m
PROPERTY INCOME (for the PAS)		
Rentals	199	497
Sales	48	177
Wayleaves	9	121
TOTAL PAS INCOME	256	795
COSTS		
Rental incremental	(2)	(7)
Disposure expenses: Net book value	-	(10)
Disposal costs	(8)	(30)
TOTAL COSTS	(10)	(47)
NET RETURN	246	748
Property allowance	244	730
SURPLUS	2	18
Property clawback at 25% of surplus	-	5
Prior year adjustment	-	(3)
	-	2

NETWORK RAIL INFRASTRUCTURE LIMITED

STATEMENT 7: SEGMENTAL ANALYSIS

Year ended 31 March 2004

	Actual performance 2003/04 £m
RAILWAY ESTATES BUSINESS	
Income	256
Direct expenditure	(224)
NET OPERATING RETURN	<u>32</u>
NETWORK BUSINESS	
Income	1,947
Direct expenditure	(5,542)
NET OPERATING RETURN	<u>(3,595)</u>
TOTAL (excluding Railway Safety/RSSB)	
Income	2,203
Direct expenditure	(5,766)
Regulatory accruals and adjustments	4,427
NET RAB OPERATING RETURN	<u>864</u>

NETWORK RAIL INFRASTRUCTURE LIMITED

STATEMENT 8: GRANTS

Year ended 31 March 2004

	Date received	Grants received 2003/04 £m	Cumulative in 2003/04 prices £m
REVENUE GRANTS			
Network grants identified in 19 October 2000 conclusions			
Due 1 April	1 April 2003	1,342	1,848
Due 1 April	20 May 2003	50	50
Due 1 October	1 October 2003	56	226
Schedule 1 grants as amended			
Due 1 April		-	-
Due 1 October		-	354
TOTAL		1,448	2,478

NETWORK RAIL INFRASTRUCTURE LIMITED

APPENDIX A: RECONCILIATION OF STATUTORY OPERATING PROFIT TO REGULATORY TOTAL OPERATING RETURN Year ended 31 March 2004

		2003/04 £m
Operating loss per statutory accounts		(758)
Add: Profit on sales of properties		40
Add: operating loss of subsidiaries included in consolidated operating profit		7
		<hr/>
Profit before interest and tax		(711)
Add back:		
Capital grants and intangible fixed assets amortised	(9)	
Depreciation and other amounts written off fixed assets	695	
		<hr/>
		686
Less: renewals		(3,070)
Adjustments:		
Adjustment to network grant income		562
Other items in operating return:		
Revenue and incentive adjustment accrued and overspend allowance	3,386	
Profiling adjustment to income	47	
Capitalised financing	587	
Prior year abortive capital costs written back under depreciated replacement cost accounting for statutory fixed assets	(16)	
Thameslink 2000 control period 1 expenditure previously written off	119	
		<hr/>
		4,123
		<hr/>
TOTAL OPERATING RETURN		1,590
		<hr/> <hr/>

NETWORK RAIL INFRASTRUCTURE LIMITED

APPENDIX B: RECONCILIATION OF STATUTORY NET ASSETS TO REGULATORY NET ASSETS Year ended 31 March 2004

	2003/04 £m	2003/04 £m
Statutory net assets at 31 March 2004	3,592	
Add back taxation balances	182	
	<hr/>	
Statutory net assets at 31 March 2004 (excluding taxation balances)		3,774
Investment properties excluded from regulatory net assets	(78)	
Adjustment to restate debt at market value	(107)	
Working capital amount included in initial RAB	504	
Difference between actual 2003/04 outturn and interim review determination	288	
Overspend adjustment	(36)	
Adjustment following calculation of final volume incentive	37	
Other	6	
	<hr/>	
		614
		<hr/>
REGULATORY NET ASSETS AT 31 MARCH 2004		4,388
		<hr/> <hr/>
Average net total regulatory assets		3,531
TOTAL RETURN ON AVERAGE NET TOTAL REGULATORY ASSETS		48.6%
		<hr/> <hr/>

NETWORK RAIL INFRASTRUCTURE LIMITED

APPENDIX C: RECONCILIATION OF STATUTORY FIXED ASSETS TO REGULATORY FIXED ASSETS Year ended 31 March 2004

	2003/04 £m	2003/04 £m
Net book value of railway network in statutory fixed assets at 31 March 2004		18,498
Amounts included in total RAB valuation not included in statutory fixed assets:		
Capital grants carried as statutory creditors	(702)	
Deferred fixed assets carried as statutory current assets	105	
Overspend adjustment	(36)	
Adjustment following calculation of final volume incentive	37	
		(596)
REGULATORY FIXED ASSETS AT 31 MARCH 2004		17,902

APPENDIX D: OTHER NOTES

NOTE 1 - TAXATION

Year ended 31 March 2004

The methodology set out in note (m) to the Statement of Accounting Policies broadly seeks to value the tax allowances included in the statutory financial statements and discount them over the projected pre-tax cash flows attributable to the regulatory net assets of the Company.

This methodology differs from Financial Reporting Standard 19 “Deferred Tax” (“FRS 19”). The most significant differences are as follows:

- The discount rate required to be used by FRS 19 is the post tax yield on Government bonds with maturity dates similar to those of the deferred tax assets or liabilities. The discount rate specified in the guidance note to be incorporated into the updated Regulatory Accounting Guidelines is higher and has the effect of decreasing the net present value of future liabilities and assets in the regulatory financial statements.
- Under FRS 19 deferred tax assets are recognised to the extent that they are recoverable against suitable taxable profits. The Regulatory Accounting Guidelines only allow the recognition of deferred tax assets to the extent that they can be netted off against deferred tax liabilities. Any net deferred tax assets are not recognised.
- Short term timing differences are not recognised in the regulatory financial statements unless they have a material impact on the deferred tax asset or provision.

The deferred tax asset not recognised in the regulatory financial statements is in respect of the following:

	2003/4 £m
Taxation losses	911
Timing differences on fixed assets	1,605
	<hr/>
Deferred tax asset not recognised	2,516
	<hr/> <hr/>

The post-tax cash flows of the operating component of the balance sheet need to be discounted at a rate consistent with a post-tax return of 6.48% in order to equal the equivalent pre-tax cash flows discounted at a rate consistent with a pre-tax return of 8%. This implies that there is an effective rate of tax on operating returns of 19.0%.