

**NETWORK RAIL INFRASTRUCTURE
LIMITED**
(formerly Railtrack PLC)

Regulatory financial statements
for the year ended
31 March 2003

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

REGULATORY FINANCIAL STATEMENTS 2003

CONTENTS	Page
Directors' review	I
Statement of directors' responsibilities	5
Independent auditors' report	6
Part A – Statement of regulatory financial performance	9
Part B – Statement of regulatory financial position	11
Statement of accounting policies	13
Statement 1: RAB adjustments and accruals	20
Statement 2: Detailed analysis of enhancement spend	22
Statement 3: Income statement	23
Statement 4: Expenditure statement	24
Statement 5: Renewals Costs by Asset Category	25
Statement 6: Property allowance scheme	26
Statement 7: Segmental Analysis	27
Statement 8: Grants	28
Appendix A: Reconciliation of statutory operating profit to regulatory total operating return	29
Appendix B: Reconciliation of statutory net assets to regulatory net assets	30
Appendix C: Reconciliation of statutory fixed assets to regulatory fixed assets	31
Appendix D: Other notes	32

NETWORK RAIL INFRASTRUCTURE LIMITED

(formerly Railtrack PLC)

DIRECTORS' REVIEW

The directors of Network Rail Infrastructure Limited are pleased to present the regulatory financial statements for the year ended 31 March 2003. 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 2003 was £557 million compared with that in the Periodic Review of Railtrack's Access Charges: Final Conclusions published by the Rail Regulator in October 2000 ("the regulatory determination") of £540 million. The company overspent the original determination by £1,865 million in the year. 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 Limited this overspend has been included as an increase in RAB and treated as regulatory income in the regulatory financial statements.

The RAB operating return reflects an 8.3% 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 £12 million (which are subject to clawback under the property allowance scheme), various incentives of £34 million and enhancement overspend written back to RAB of £13 million.

The total operating return for the year, which includes income and expenditure on assets that are outside of the regulatory asset base, was £886 million. This total operating return of £886 million compares to a reported operating profit in the company's statutory accounts for the year ended 31 March 2003 of £80 million. 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 £12,442 million compared with a regulatory determination of £9,061 million. The difference between the totals reflects the RAB adjustments that will be included in the 2006 RAB valuation in accordance with the principles established in the statement made on 27 June 2002 and the second interim review consultation document and has been agreed with the Rail Regulator. Reasons for the excess spend are given below.

The 'logged up' valuation of the RAB at 31 March 2003 is £7,017 million which is £43 million lower than the regulatory determination of £7,060 million. The net total regulatory assets of Network Rail Infrastructure Limited at 31 March 2003 were £2,673 million compared with net assets reported in the statutory financial statements of £1,748 million. A net assets reconciliation is provided in Appendix B, with a reconciliation of the RAB and ring fenced assets to statutory fixed assets in Appendix C.

DIRECTORS' REVIEW

Material variations from the regulatory determination

Income

The main variance from the 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 £381 million. This is a reflection of further work undertaken to regain control of the network post-Hatfield, outlined further below. The overall income variance compared with the determination, after taking into account the overspend adjustment is a negative variance of £17 million.

Expenditure

The overall expenditure variance, before taking account of the Rail Regulator's statement, was a negative variance of £1,466 million. 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. Key drivers for the increase in track renewals 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.
- **Train control renewals**, which comprise signalling and telecoms renewals, where the company has significantly underspent the regulatory determination. This reflects slower than originally planned development of GSM-R and replacement of the Fixed Telecom Network and deferral of signalling expenditure, particularly on the West Coast Route Modernisation ("WCRM") programme as the scope for Phase II has developed.
- **Other costs**, which comprise staff costs and other production and management costs have risen as a result of various items, particularly increased signalling staff costs, the increased pension charges for the Railways Pension Scheme as a consequence of a general fall in investment values, as well as the impact of provisions against claims, the increased costs of insurance and some feasibility costs written off.

RAB and RAB adjustments for 2006

Adjustments for amounts spent in excess of the regulatory determination have been incorporated into the RAB as an accumulated adjustment carried forward to 2006, though such adjustment may be reflected earlier in the interim review. These adjustments total some £2,092 million for the year and cumulatively total £3,107 million. The reasons for the overspend are outlined above.

NETWORK RAIL INFRASTRUCTURE LIMITED **(formerly Railtrack PLC)**

DIRECTORS' REVIEW

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 11 April 2001, ("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 UK generally accepted accounting principles ("UK GAAP"). Network Rail Infrastructure Limited's statutory accounts for the year ended 31 March 2003 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.

Fundamental Uncertainty – West Coast Route Modernisation ("WCRM")

In preparing the regulatory financial statements the directors have considered a fundamental uncertainty relating to WCRM. During the year the company has been seeking an agreement with Virgin Trains Limited ("Virgin"), the Strategic Rail Authority ("SRA") and the Office of the Rail Regulator ("ORR") on a revised contract and output specification in respect of the WCRM. At the date of approval of the regulatory financial statements the SRA has concluded its review of the optimal capacity utilisation of the West Coast Mainline and the infrastructure necessary to support this capacity, and published its West Coast strategy. However, the ORR has still to review the SRA's proposals and consent to them.

There is a fundamental uncertainty as to the outcome of the ORR's review and it is therefore not possible to quantify with any certainty the potential costs to the company of any settlement with Virgin or the extent to which they would need to be provided for in the statement of regulatory performance or the statement of regulatory financial position at 31 March 2003. In the opinion of the directors it would be seriously prejudicial for the company to attempt to disclose any further information about the uncertainties or the potential financial effect of possible outcomes.

Interim Review

The costs of operating, maintaining and renewing the railway infrastructure have risen over the past two years for the reasons described on the previous page and, as a consequence, have significantly exceeded the assumptions underlying the last periodic review. This is not a sustainable position and the Rail Regulator is therefore undertaking an interim review of our revenue requirements that should result in access charges which are consistent with our expenditure requirements and output commitments. Any adjustment to charges arising from this review should take effect from April 2004 onwards.

By order of the board

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

DIRECTORS' REVIEW

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 11 April 2001.

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

- prepare the regulatory financial statements in respect of the year ended 31 March 2003 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 formally approve 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 11 July 2003, we have audited the regulatory financial statements of Network Rail Infrastructure Limited for the year ended 31 March 2003 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 UK 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.

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 11 April 2001 ("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 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 2003 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 prepared solely for the confidential use of Network Rail Infrastructure Limited and the ORR, and solely for the purpose of Network Rail Infrastructure Limited's compliance with the obligations of its licence. It may not be relied upon by you for any other purpose whatsoever. Deloitte & Touche neither owes nor accepts any duty to any other party and shall not be liable for loss, damage or expense of whatsoever nature which is caused by their reliance on our report.

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, which are prepared for a different purpose.

Fundamental uncertainty

In forming our opinion, we have considered the adequacy of disclosures made in the statement of accounting policies included in the regulatory financial statements, concerning a fundamental uncertainty relating to the West Coast Route Modernisation (“WCRM”). During the year the company has been seeking an agreement with Virgin Trains Limited (“Virgin”), the Strategic Rail Authority (“SRA”) and the ORR on a revised contract and output specification in respect of the WCRM. At the date of approval of the regulatory financial statements the SRA has concluded its review of the optimal capacity utilisation of the West Coast Mainline and the infrastructure necessary to support this capacity, and published its West Coast strategy. However, the ORR has still to review the SRA’s proposals and consent to them.

There is a fundamental uncertainty as to the outcome of the ORR’s review and it is therefore not possible to quantify with any certainty the potential costs to the company of any settlement with Virgin or the extent to which they would need to be provided for in the statement of regulatory performance or the statement of regulatory financial position at 31 March 2003. Our opinion is not qualified in this respect.

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 2003 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
Chartered Accountants
London
31 July 2003

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

PART A – STATEMENT OF REGULATORY FINANCIAL PERFORMANCE

Year ended 31 March 2003

	Not es	Actual performa nce 2002/03 £m	ORR Determina tion 2002/03 £m	Differen ce 2002/03 £m	Cumulati ve Differenc e in 2002/03 prices £m
INCOME					
Franchise access	S3	1,356	1,821	(465)	(925)
Other single till	S3	454	550	(96)	(195)
Property income	S3/S6	252	240	12	52
Total revenue and incentive adjustment accrued and overspend allowance		663	131	532	1,125
Grants adjustment		939	939	-	-
Profiling adjustment accrued	S1	269	269	-	-
Total		<u>3,933</u>	<u>3,950</u>	<u>(17)</u>	<u>57</u>
EXPENDITURE					
Renewals	S4	(2,371)	(1,783)	(588)	(664)
Maintenance	S4	(1,184)	(692)	(492)	(756)
Opex own costs	S4	(1,036)	(606)	(430)	(691)
Joint industry costs	S4	(284)	(328)	44	71
Total expenditure adjustment for overspend allowance	S1	1,479	-	1,479	2,092
Total		<u>(3,396)</u>	<u>(3,409)</u>	<u>13</u>	<u>52</u>
RAB ADJUSTMENTS					
RAB depreciation		-	(1)	1	1
Capitalised financing		20	-	20	26
Total		<u>20</u>	<u>(1)</u>	<u>21</u>	<u>27</u>
NET RAB OPERATING RETURN		<u>557</u>	<u>540</u>	<u>17</u>	<u>136</u>
CAPITALISED FINANCING OF REGULATORY ACCRUALS AND GRANTS					
		270			
NON-RAB ACTIVITIES					
Project gains and losses	S2	(13)			
Capitalised financing		37			
Working capital adjustments		35			
Return on ring-fenced activities		<u>59</u>			
TOTAL OPERATING RETURN		<u>886</u>			

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

PART A – STATEMENT OF REGULATORY FINANCIAL PERFORMANCE

Year ended 31 March 2003

INTEREST

Interest	(482)
Movement in market value of debt	40

Real interest cost	(442)
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Inflation adjustments to RAB and other items	341
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Tax	6
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TOTAL RETURN	791
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NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

PART B – STATEMENT OF REGULATORY FINANCIAL POSITION

Year ended 31 March 2003

	Notes	Actual performance 2002/03 £m	ORR determination 2002/03 £m	Difference 2002/03 £m
ASSET BASE ANALYSIS				
Opening RAB	SI	6,596	6,547	49
Value added through enhancements	SI	421	513	(92)
Subtotal		7,017	7,060	(43)
RAB incentive adjustments accrued	SI	109	287	(178)
RAB revenue adjustments accrued	SI	1	-	1
Cumulative allowance for overspend	SI	3,107	-	3,107
Retiming of SRA grants and deferred income	SI	1,393	898	495
Profiling adjustment to income	SI	815	816	(1)
Total RAB valuation		12,442	9,061	3,381
Non-RAB enhancements accrued		793		
		13,235		
Working capital		(1,414)		
Working capital amount included in initial RAB		493		
Net operating assets		12,314		
Net debt		(9,636)		
Tax balances – Deferred taxation		-		
– Corporation tax		(5)		
Net total regulatory assets		2,673		
Average rolling RAB valuation		6,714		
NET RAB OPERATING RETURN ON AVERAGE RAB				
		8.3%	8.0%	0.3%
Average net total regulatory assets		2,276		
TOTAL RETURN ON AVERAGE NET TOTAL REGULATORY ASSETS				
		34.8%		

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

PART B – STATEMENT OF REGULATORY FINANCIAL POSITION

Year ended 31 March 2003

Approved by order of the board of directors on
Signed on behalf of the board of directors

31 July 2003

John Armitt

Ron Henderson

NETWORK RAIL INFRASTRUCTURE LIMITED

(formerly Railtrack PLC)

STATEMENT OF ACCOUNTING POLICIES

Year ended 31 March 2003

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 11 April 2001, ("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 UK 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 2003 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 profit in the statutory accounts to the total operating return reported in the regulatory financial statements.

Fundamental uncertainty – West Coast Route Modernisation ("WCRM")

In preparing the regulatory financial statements the directors have considered a fundamental uncertainty relating to WCRM. During the year the company has been seeking an agreement with Virgin Trains Limited ("Virgin"), the Strategic Rail Authority ("SRA") and the Office of the Rail Regulator on a revised contract and output specification in respect of the WCRM. At the date of approval of the regulatory financial statements the SRA has concluded its review of the optimal capacity utilisation of the West Coast Mainline and the infrastructure necessary to support this capacity, and published its West Coast strategy. However, the ORR has still to review the SRA's proposals and consent to them.

There is a fundamental uncertainty as to the outcome of the ORR's review and it is therefore not possible to quantify with any certainty the potential costs to the company of any settlement with Virgin or the extent to which they would need to be provided for in the statement of regulatory performance or the statement of regulatory financial position at 31 March 2003. In the opinion of the directors it would be seriously prejudicial for the company to attempt to disclose any further information about the uncertainties or the potential financial effect of possible outcomes.

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.

Accounting policies

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

STATEMENT OF ACCOUNTING POLICIES

Year ended 31 March 2003

(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.

STATEMENT OF ACCOUNTING POLICIES
Year ended 31 March 2003

(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.

(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 the 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

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

STATEMENT OF ACCOUNTING POLICIES
Year ended 31 March 2003

- (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 2003; 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).

(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

STATEMENT OF ACCOUNTING POLICIES
Year ended 31 March 2003

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 various derivative products, principally interest rate swaps and forward rate agreements, to manage its exposure to interest rate fluctuations on its debt portfolio. Amounts payable or receivable in respect of these transactions are recognised as adjustments to interest expense over the period of the contracts. Termination payments made or received in respect of derivatives are spread over the life of the underlying exposure in cases where the underlying exposure continues to exist. In other cases any termination payments are taken to the profit and loss account. No transactions of a speculative or trading nature are undertaken.

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.

(k) Financial instruments (continued)

The discount of principal and related fees associated with the issue of eurobonds and exchangeable bonds is accounted for as a reduction in the balance outstanding of the eurobonds and exchangeable bonds, and is amortised over the lives of the bonds. The amortisation charge is included within interest payable.

STATEMENT OF ACCOUNTING POLICIES
Year ended 31 March 2003

(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 2003 is calculated in Statement 6.

(m) Taxation

Corporation tax

The corporation tax credit in respect of tax losses for the year, after 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 pre-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, ie. 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;

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

STATEMENT OF ACCOUNTING POLICIES

Year ended 31 March 2003

- 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.

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

STATEMENT 1: RAB ADJUSTMENTS AND ACCRUALS
Year ended 31 March 2003

Calculation of RAB

		Movements in the year					
	Receipt of grant payme nts	Income adjust ments	Expendi ture adjustm ents	Capital ised financi ng	Inflatio n		Total
Openin g value £m	£m	£m	£m	£m	£m		£m

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

STATEMENT 1: RAB ADJUSTMENTS AND ACCRUALS
Year ended 31 March 2003

Opening RAB	6,394	-	-	-	4	198	6,596
Incentive and other non-enhancement adjustments							
Volume incentive (freight and passenger)	48	-	15	-	2	1	66
Capacity charge shortfall	4	-	-	-	-	-	4
Broken rails adjustment	17	-	19	-	2	1	39
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	-	399	1,479	156	58	3,107
Retiming of SRA grants and deferred income	633	(492)	1,169	-	61	22	1,393
Profiling adjustments to income	478	-	269	-	49	19	815
Enhancements							
Enhancements and other expenditure in the year (Statement 2)				398	16	7	421
Adjustment to be incorporated in 2004 RAB	<u>2,196</u>	<u>(492)</u>	<u>1,871</u>	<u>1,877</u>	<u>286</u>	<u>108</u>	<u>5,846</u>
Closing RAB	<u>8,590</u>	<u>(492)</u>	<u>1,871</u>	<u>1,877</u>	<u>290</u>	<u>306</u>	<u>12,442</u>

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

STATEMENT 2: DETAILED ANALYSIS OF ENHANCEMENT SPEND
Year ended 31 March 2003

	Movement in the year				
	ORR				
	determination				
	for				
	RAB	Ring-	Total	RAB	Difference
	£m	fenced	£m	£m	£m
		£m			
Analysis of enhancements					
Train protection scheme	140	-	140	176	(36)
Platform stepping	-	-	-	15	(15)
Track & signalling IOS schemes	(2)	-	(2)	209	(211)
Performance related	-	-	-	11	(11)
Waterloo – Fawkham Junction	26	-	26	26	-
ECML Phase I	11	-	11	-	11
Stations IOS	9	-	9	76	(67)
Total	<u>184</u>	<u>-</u>	<u>184</u>	<u>513</u>	<u>(329)</u>
Other enhancement allowances					
Project gains and losses	-	(13)	(13)	-	(13)
Stations and depots renewal	35	-	35	-	35
Other enhancement projects	179	229	408	1,518	(1,110)
Total	<u>214</u>	<u>216</u>	<u>430</u>	<u>1,518</u>	<u>(1,088)</u>
Total enhancements	<u>398</u>	<u>216</u>	<u>614</u>	<u>2,031</u>	<u>(1,417)</u>

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

STATEMENT 3: INCOME STATEMENT
Year ended 31 March 2003

	Actual performance 2002/03 £m	ORR Determination 2002/03 £m	Difference 2002/03 £m	Cumulative difference in 2002/03 prices £m
FRANCHISE ACCESS INCOME				
FIXED CHARGES				
Railway Safety charge	37	37	-	(3)
Base charge	1,426	1,492	(66)	(101)
Schedule 4 supplements	45	45	-	-
Schedule 8 supplements	2	4	(2)	(4)
Other	2	-	2	4
TOTAL FIXED CHARGES	1,512	1,578	(66)	(104)
VARIABLE CHARGES				
Usage charge	165	157	8	14
Capacity charge	1	-	1	1
EC4T	120	148	(28)	(36)
Schedule 4 compensation	(46)	(48)	2	(29)
Schedule 8 penalty	(396)	(14)	(382)	(771)
TOTAL VARIABLE CHARGE	(156)	243	(399)	(821)
TOTAL FRANCHISE ACCESS INCOME	1,356	1,821	(465)	(925)
OTHER INCOME				
Freight access	83	193	(110)	(218)
Open access	60	51	9	8
Station charges	266	264	2	9
Depot charges	42	40	2	5
Other	3	2	1	1
TOTAL OTHER SINGLE TILL	454	550	(96)	(195)
PROPERTY INCOME	252	240	12	52
TOTAL OTHER INCOME	706	790	(84)	(143)

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

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

STATEMENT 4: EXPENDITURE STATEMENT
Year ended 31 March 2003

	Actual performance 2002/03 £m	ORR Determination 2002/03 £m	Difference 2002/03 £m	Cumulative difference in 2002/03 prices £m
RENEWALS				
Track	905	462	(443)	(698)
Train control	660	804	144	433
Electrification	143	105	(38)	(72)
Structures	362	204	(158)	(225)
Station and depots	106	105	(1)	19
IS expenditure	141	76	(65)	(40)
Plant and machinery	41	23	(18)	(75)
Other	13	4	(9)	(6)
TOTAL RENEWALS	2,371	1,783	(588)	(664)
MAINTENANCE				
Track	655	382	(273)	(420)
Train control	305	179	(126)	(193)
Electrification	58	34	(24)	(37)
Other	166	97	(69)	(106)
TOTAL MAINTENANCE	1,184	692	(492)	(756)
OPEX OWN COSTS				
Signalling staff costs	246	146	(100)	(164)
Other staff costs	315	237	(78)	(100)
Other production and management costs	475	223	(252)	(427)
TOTAL OWN COSTS	1,036	606	(430)	(691)
JOINT INDUSTRY COSTS				
Railway Safety costs	37	37	-	3
EC4T	100	128	28	51
Cumulo rates	105	120	15	15
BT police	36	36	-	-
ORR licence fee	6	7	1	2
TOTAL JOINT INDUSTRY	284	328	44	71

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
(formerly Railtrack PLC)

STATEMENT 5: RENEWALS COSTS BY ASSET CATEGORY
Year ended 31 March 2003

	Actual performance 2002/03 £m	ORR Determination 2002/03 £m	Difference 2002/03 £m	Cumulative difference in 2002/03 prices £m
RENEWALS				
Non WCRM				
Track	609	306	(303)	(575)
Train control	357	403	46	177
Electrification	26	53	27	40
Structures	318	174	(144)	(215)
Stations and depots	106	105	(1)	19
IT	141	76	(65)	(40)
Plant and machinery	39	23	(16)	(72)
Other	14	4	(10)	(9)
Total non WCRM	1,610	1,144	(466)	(675)
WCRM				
Track	296	156	(140)	(123)
Train control	303	401	98	256
Electrification	117	52	(65)	(112)
Structures	44	30	(14)	(10)
Stations and depots	-	-	-	-
IT	-	-	-	-
Plant and machinery	2	-	(2)	(3)
Other	(1)	-	1	3
Total WCRM	761	639	(122)	11

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

STATEMENT 6: PROPERTY ALLOWANCE SCHEME (PAS)
Year ended 31 March 2003

	2002/03 £m	Cumulative to date (in 2002/03 prices) £m
PROPERTY INCOME (for the PAS)		
Rentals	154	290
Sales	51	126
Wayleaves	47	109
First Reserved Rents (stations)	-	-
TOTAL PAS INCOME	252	525
COSTS		
Rental incremental	(2)	(5)
Disposure expenses: Net book value	-	(10)
Disposal costs	(15)	(22)
TOTAL COSTS	(17)	(37)
NET RETURN	235	488
Property allowance	240	472
(DEFICIT)/SURPLUS	(5)	16
Property clawback at 25% of surplus	-	4
Prior year adjustment	-	(3)
	-	1

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

STATEMENT 7: SEGMENTAL ANALYSIS
Year ended 31 March 2003

	Actual performance 2002/03 £m
MAJOR STATIONS BUSINESS	
Income	125
Direct expenditure	(111)
NET OPERATING RETURN	<u>14</u>
PROPERTY BUSINESS	
Income	252
Direct expenditure	(80)
NET OPERATING RETURN	<u>172</u>
NETWORK BUSINESS	
Income	1,648
Direct expenditure	(4,647)
NET OPERATING RETURN	<u>(2,999)</u>
TOTAL (excluding Railway Safety/RSSB)	
Income	2,025
Direct expenditure	(4,838)
Regulatory accruals and adjustments	3,370
NET OPERATING RETURN	<u>557</u>

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

STATEMENT 8: GRANTS
Year ended 31 March 2003

		Grants due/recei ved 2002/03 £m	Cumulati ve in 2002/03 prices £m
	Date received		
REVENUE GRANTS			
Network grants identified in 19 October 2000 conclusions			
Due 1 April	2 April 2002	492	492
Due 1 October		-	165
Schedule 1 grants as amended			
Due 1 April		-	-
Due 1 October		-	344
Schedule 2 grants as amended			
Due 1 April		-	-
Due 1 October		-	-
TOTAL		492	1,001

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

**APPENDIX A: RECONCILIATION OF STATUTORY OPERATING PROFIT TO
REGULATORY TOTAL OPERATING RETURN**
Year ended 31 March 2003

		2002/03
		£m
Operating profit per Statutory Accounts		80
Add: Profit on sales of properties		45
Add: Operating loss of subsidiaries included in consolidated operating profit		3
		<hr/>
Profit before interest and tax		128
Add Back:		
Capital grants and intangible assets amortised	(12)	
Depreciation and other amounts written off	438	
	<hr/>	
		426
Less: Renewals		(2,371)
Adjustments:		
Adjustment to Network Grant Income		(57)
Other items in Operating Return:		
Revenue and incentive adjustment accrued and overspend allowance	2,142	
Profiling adjustment to income	269	
Capitalised financing	327	
Working capital adjustments	35	
Project gains and losses	(13)	
	<hr/>	
		2,760
		<hr/>
TOTAL OPERATING RETURN		886
		<hr/> <hr/>

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

**APPENDIX B: RECONCILIATION OF STATUTORY NET ASSETS TO
REGULATORY NET ASSETS**
Year ended 31 March 2003

	2002/03	2002/03
	£m	£m
Statutory net assets at 31 March 2003	1,748	
Add back taxation balances	523	
	<hr/>	
Statutory net assets at 31 March 2003 (excluding taxation balances)		2,271
Investment properties excluded from regulatory net assets	(71)	
Backlog provision included in regulatory net assets	(11)	
Adjustment to restate debt at market value	(40)	
Working capital amount included in initial RAB	493	
Overspend adjustments	40	
Other	(4)	
	<hr/>	
		407
		<hr/>
Regulatory net assets at 31 March 2003 (excluding taxation balances)		2,678
Taxation balances		(5)
		<hr/>
REGULATORY NET ASSETS AT 31 MARCH 2003		2,673
		<hr/> <hr/>

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

**APPENDIX C: RECONCILIATION OF STATUTORY FIXED ASSETS TO
REGULATORY FIXED ASSETS**
Year ended 31 March 2003

	2002/03	2002/03
	£m	£m
Net book value of railway network in statutory fixed assets at 31 March 2003		12,764
Amounts included in total RAB valuation not included in statutory fixed assets:		
Capital grants carried as statutory creditors	(690)	
Revenue grant debtor carried as a statutory current asset	996	
Deferred fixed assets carried as statutory current assets	125	
Other overspend adjustments	40	
	<hr/>	471
REGULATORY FIXED ASSETS AT 31 MARCH 2003		<hr/> 13,235 <hr/>

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

APPENDIX D: OTHER NOTES

NOTE I – RELATED PARTIES

Year ended 31 March 2003

Network Rail Infrastructure Limited is a wholly owned subsidiary of Network Rail (Holdco) Limited. Its ultimate parent company is Network Rail Limited.

During the year to 31 March 2003 Network Rail Infrastructure Limited entered into the following transactions with related parties:

- Management services were provided to RT Telecom Services Limited. These charges related mainly to staff time incurred on this company's projects.
- During the year Network Rail Infrastructure Limited sold properties to Railtrack Group PLC for a consideration of £6.3 million. These transactions were on an arm's length basis.
- Network Rail Infrastructure Limited has in place insurance arrangements through Network Rail Insurance Limited.
- Network Rail Infrastructure Limited continued its relationship with Railway Safety.
- Network Rail Infrastructure Limited pays an annual licence fee to ORR which is disclosed in Statement 4.
- During the course of the year the company provided technical advice and project management resource to Union Railways (South) Limited, in respect of construction of the Channel Tunnel Rail Link. All transactions were on an arm's length basis.
- Before the advent of administration the company provided services and facilities to Railtrack Group PLC, including the provision of office space, use of information technology, staff resources for payroll, accounting and corporate affairs functioning, treasury services and company secretarial resources. Subsequent to administration these resources were separated as far as possible with different facilities, premises and personnel. Where services continued to be shared, reimbursement of relevant costs was invoiced to Railtrack Group PLC.
- David Bailey, a non-executive Director of the company is also a Director of the SRA. Various rental agreements are in place with the SRA and grant payments are received from them.

NETWORK RAIL INFRASTRUCTURE LIMITED
(formerly Railtrack PLC)

APPENDIX D OTHER NOTES

NOTE 2 - POST BALANCE SHEET EVENTS

Year ended 31 March 2003

On 1 April 2003 the activities of Railway Safety Limited were transferred to Railway Safety and Standards Board, an entity independent of Network Rail Infrastructure Limited.

On 9 July 2003 Network Rail Infrastructure Limited and four of its employees were charged by the Crown with involuntary manslaughter and an offence under the Health and Safety at Work, etc Act. Chris Leah, a director of the company, has been charged with an offence under the Health and Safety at Work, etc Act. Both the company and its employees fully intend to defend themselves against these charges.

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 recovered 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:

	2002/3 £m
Taxation losses	336
Timing differences on fixed assets	1,228
	<hr/>
Deferred tax asset not recognised	<u>1,564</u>

The post-tax cash flows of the operating component of the balance sheet need to be discounted at a rate of 6.53% in order to equal the equivalent pre-tax cash flows discounted at 8%. This implies that there is an effective rate of tax on operating returns of 18.9%.