Financial statements

Financial statements

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Independent auditor's report to the members of Network Rail Limited

Opinion on financial statements

I have audited the financial statements of Network Rail Limited ('the company') for the year ended 31 March 2020 which comprise:

- the group income statement and statement of comprehensive income;
- the group statement of changes in equity;
- the group and parent company balance sheets;
- the group and parent company statement of cash flows;
- and the related notes, including the significant accounting policies.

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006. I have also audited the information in the Directors' Remuneration Report that is described as having been audited.

In my opinion the financial statements:

- give a true and fair view of the state of Group's and the parent company's affairs as at 31 March 2020 and of the group's loss for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and
- have been prepared in accordance with the Companies Act 2006.

Opinion on regularity

In my opinion, in all material respects the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Conclusions relating to principal risks, going concern and viability statement

I have nothing to report in respect of the following information in the annual report, in relation to which the ISAs (UK) require me to report to you whether I have anything material to add or draw attention to:

- the disclosures in the annual report that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation in the annual report that they have carried out a robust assessment of the principal risks facing the group and the parent company, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the group and the parent company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- whether the directors' statement relating to going concern required under the Listing Rules in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with my knowledge obtained in the audit; or
- the directors' explanation in the annual report as to how they have assessed the prospects of the group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the group and the parent company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Basis of opinions

I conducted my audit in accordance with International Standards on Auditing (ISAs) (UK) and Practice Note 10 'Audit of Financial Statements of Public Sector Entities in the United Kingdom'. My responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of my report. Those standards require me and my staff to comply with the Financial Reporting Council's Revised Ethical Standard 2016. I am independent of Network Rail Limited in accordance with the ethical requirements that are relevant to my audit and the financial statements in the UK. My staff and I have fulfilled our other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

The regularity framework described in the table below has been applied:

Regularity Framework	
Authorities for a company	Companies Act 2006 / Articles of Assocation
Operating requirements	Network Licence
HM Treasury and related authorities	Managing Public Money

Overview of my audit approach

Key audit matters

Key audit matters are those matters that, in my professional judgment, were of most significance in my audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that I identified.

I consider the following areas of particular audit focus to be those areas that had the greatest effect on my overall audit strategy, the allocation of resources in my audit and directing the efforts of the audit team in the current year. These matters were addressed in the context of my audit of the financial statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters.

This is not a complete list of all risks identified by my audit but only those areas that had the greatest effect on my overall audit strategy, allocation of resources and direction of effort. I have not, for example, included information relating to the work I have performed on the significant risk of management override of controls.

The areas of focus were discussed with the Audit and Risk Committee; their report on matters that they considered to be significant to the financial statements is set out on pages 88 to 95.

In this year's report the following changes to the risks identified have been made compared to my prior year report.

Matters connected with heightened estimation uncertainty
- In assessing the valuation of the railway network, my overall procedures have been similar but as described in the key audit matter below, I have been mindful of the economic uncertainties produced by the COVID-19 pandemic, and the judgements made by management in forecasting the future financial performance within Control Period 6 (2019-2024) which a theoretical buyer might take into account.
- The valuation of Network Rail's pension deficit appears again as a key audit matter. We have focussed greater attention this year on the valuation of pension assets given the economic uncertainties that existed at the balance sheet date as a result of the COVID-19 pandemic.

Matters driven by material accounting policy changes
- Network Rail has adopted IFRS 16 – Leases for the first time in 2019-20. I have identified the completeness of the leases recorded under the new standard as right of use assets and corresponding liabilities as a key audit matter.

Matters where risk has reduced
- I have rebutted the risk of fraud through revenue recognition as a significant risk for 2019-20. I previously recognised this risk with respect to property and commercial income. However since the sale of much of the property portfolio (the 'Arches') in 2018-19 the revenue, and associated risk, has decreased significantly.
- The first time adoption of IFRS 9 was included as a key audit matter for 2018-19 but has been removed for 2019-20 as the risk was specific to the first time adoption of the standard.

Independent auditor's report continued

Property, plant and equipment – valuation of the rail network

Description of risk

The group accounts for the rail network as a single asset carried in the Balance Sheet at its fair value. In the absence of an active market, fair value is estimated using the discounted cash flows associated with the asset.

As explained in Note 12 to the financial statements, the group continues to use the Regulated Asset Base ('RAB') as the starting point for its discounted cash flow valuation of the railway network. This is on the basis that a private owner of the railway network asset would have its revenue requirement determined using the building block model of regulation.

The value of the RAB at 31 March 2020 (after the effects of inflation, qualifying capital expenditure, and amortisation) is £72.5 billion. Management continues to acknowledge that, in pricing the asset, an investor would make an assessment of the deliverability of the current regulatory determination, and a discount of £475 million has been applied to the RAB value in determining the fair value of the rail network asset at the reporting date (31 March 2019: discount of £281 million). This is termed the Performance Adjustment and, as in previous years, has been calculated based on management's own performance forecasts for the remainder of the current Control Period. As per management's disclosures in Note 2 under 'Critical accounting judgements and sources of uncertainty' and in Note 12, inherent estimation uncertainty in this area is considerable in light of the forecasting element. This year, management have specifically considered the impact of COVID-19 and notes a specific assumption about the return of property income (principally from managed stations) to baseline levels by 2021-22.

A further discount of £251 million (31 March 2019: discount of £232 million) has been applied to reduce the reported fair value of the rail network asset to £71.8 billion (31 March 2019: £71.5 billion). This adjustment is equal to the value of assets separately recognised as Investment Property and Assets Held for Sale, and is applied on the basis that the under the traditional regulatory model, the revenue requirement of the regulated entity is calculated net of the income the entity expects to generate from the property assets. Further information is included in note 12.

In evaluating the value of the RAB, I focussed my audit effort on the continuing validity of the underlying valuation assumptions, and on the estimation of the Performance Adjustment.

How the scope of my audit responded to the risk

Evaluating underlying valuation assumptions
Having read the regulator's determination for CP6, I considered whether a market participant could reasonably expect their revenue requirement to be determined using the traditional regulatory funding model. I assessed as reasonable management's judgement that a market participant would value the railway network asset by reference to the RAB.

I confirmed with the regulator that, in their view, the sale of all (or part) of the railway network could take place without a regulatory re-opener (i.e. a new regulatory determination with revised outputs and a revised assessment of efficient costs). Accordingly, I assessed as reasonable management's judgement that in valuing the railway network asset a market participant would make an adjustment to deliverability of the current regulatory determination. I also reviewed the reasonableness of the other underpinning assumptions noted in Note 12.

Addressing measurement uncertainty – the performance adjustment
The company has measured the performance adjustment as the difference between its revised CP6 Delivery Plan, updated at 31 March 2020 to reflect its latest forecast, and the CP6 regulatory baseline.

I evaluated the appropriateness of the method of measurement, and the inherent assumptions, by assessing the ongoing validity of the theoretical assumptions underpinning this RAB-based valuation, and assessing management's performance forecast against relevant metrics.

I am satisfied with the ongoing validity of the theoretical assumptions following a detailed review on the impact of CP6.

I have also assessed management's measurement of the performance adjustment relevant to a third party as reasonable. I obtained this assurance by evaluating, at a high-level, the company's performance forecasts for CP6 against its historic and emerging performance trends, as well as publicly available performance metrics and my wider understanding of the business. I also considered management's assumptions in respect of the impact of COVID-19, for example in respect of the future prospects of commercial income, in determining whether inputs to the estimate were within a reasonable range.

In the course of completing this work, I did not identify any material misstatements in the valuation of the railway network recognised, and disclosed, in the financial statements.

Defined Benefit Pensions Scheme – valuation of deficit

The group is party to several pension schemes. Based on risk and value, I focussed my work most heavily on the Network Rail section of the Railway Pensions Scheme ('RPS'). I have focussed greater attention on the valuation of the scheme assets this year as a result of the COVID-19 pandemic and resultant market volatility. The balances related to this section reflect, respectively, 96 % and 94 % of the group's total assets and liabilities in respect of defined benefit pension schemes, with the Career Average Retained Earnings ('CARE') scheme making up the remainder. Both schemes are on a 60:40 shared cost basis between the group and scheme members.

There is significant complexity, and inherent estimation uncertainty, in the valuation of the net position of the RPS scheme in respect of both the assets and liabilities contributing to the net position which is detailed in Note 26 to the financial statements. Scheme movements are presented on an aggregated basis in this note for the RPS and CARE schemes, inclusive of members' share, as are the values below.

Scheme liabilities
As with all defined benefit pension schemes, an actuarial estimate of the liability reflecting amounts to be paid out to scheme members in the future (£10,401 million as at 31 March 2020 including members' share) involves significant estimation, for example in respect of key financial assumptions.

Scheme assets
In respect of assets, an accurate and timely valuation is needed of the various asset classes held in the pension fund administered by RPMI on Network Rail's behalf (£6,951 million as at 31 March 2020 including members' share).

This has been further impacted as a result of COVID-19, particularly for assets classified at Level 3 in the fair value hierarchy (i.e. those whose prices are not readily determinable based on observations of an active market).

The standard practice of the scheme assets manager is to value investments using the most recent valuation, and if this is for a date earlier than the Balance Sheet date, to adjust for subsequent cash flows where necessary. In a stable market we have been content with this methodology, but in the context of the COVID-19 driven volatility I worked with Network Rail and the asset manager to determine enhancements which would take better account of market conditions at the year end.

The valuation of the property held by the scheme is also affected by potentially material uncertainty following the market reaction to COVID-19 which was highlighted to Network Rail by its professional valuers.

I assessed this key audit matter to be a significant risk for my audit.

How the scope of my audit responded to the risk

Scheme liabilities
I contacted Network Rail's actuaries to obtain an up to date understanding of the methodology used to calculate the main financial assumptions, and to understand the methodology and level of uncertainty involved in the roll-forward calculation.

I performed my initial assessment of the independence and expertise of these actuaries, and engaged an actuarially qualified auditor's expert to examine the assumptions, methodology and source data used to value the obligations, including both financial assumptions and the roll-forward procedures used to update membership data.

I note that financial assumptions were overall within reasonable ranges, and that changes in financial assumptions – particularly on price inflation – have been the primary cause of downward revaluation this year for pension obligations.

In the course of completing this work, I did not identify any material misstatements in the valuation of defined benefit obligations in the financial statements.

Independent auditor's report continued

Scheme assets

My work on scheme assets is informed by the results of the statutory audit of the RPS financial statements, which is independently performed by another firm, but also includes a set of direct substantive procedures to validate the asset valuations at the year end. These included sample testing over the asset valuations as at 31 March 2020 on distinctive asset classes within the Funds in which Network Rail is invested, as follows:

- for quoted and actively traded assets, I independently agreed valuations to observable market prices;
- for pooled investment assets, I agreed valuations to the investment manager valuation report and reviewed relevant observable active market data to evaluate its reliability. I have also considered potential indicators of impairment in the asset valuation; and
- for directly held property investments, I have reviewed the independent third party property valuation performed for the scheme asset manager, and made direct inquiries with their valuation experts to enable me to understand the nature of the material uncertainty and the basis on which valuations were derived on a best estimate basis.

Additionally, for private equity and non-exchange-traded pooled investment vehicles, I challenged management's expert on the extent to which standard valuation practice would take account of COVID-19 since there was the potential for variance arising from non-coterminous fund manager or professional valuations. This resulted in additional work undertaken by the asset manager to model an impact for assets which they had not yet received a valuation. I performed sample testing to validate the valuation methodology undertaken and understand the nature of the investment as well as consideration for indicators of impairment.

In the course of completing this work, I did not identify any material misstatements in the valuation of the pension scheme assets recognised, and disclosed, in the financial statements.

Accruals for capital work – valuation

Description of risk

The group's accounting for its capital investment in the railway network, for example in terms of renewals, involves a level of estimation at the year end about the amount of work delivered. This may differ from plan, for example as a result of unexpected under- or over-delivery by Network Rail's contractors. Both controllable factors (e.g. contractor project management) and uncontrollable factors (e.g. ground conditions and weather) provide a level of estimation uncertainty which the group addresses through a post-Balance Sheet review exercise which includes the Regions and other delivery areas. These factors are part of the estimation uncertainty outlined by the group under the comments concerning cost of work done in the 'Critical accounting judgements and key sources of uncertainty' section of Note 2.

Network Rail's capital accruals comprise the vast majority of the £910 million 'other accruals' in Note 18 of the financial statements as at 31 March 2020 (31 March 2019: £1,434 million). The estimate is built from the aggregation of estimates made by individual project teams, overseen by financial controllers and directors within the routes and delivery areas. The valuation carries inherent estimation uncertainty, for example as a result of the potential for optimism bias in the assessment of the quantity of work done (which would tend to overstate both accruals and PPE).

In the prior year, based on my audit findings, I had discussed with both management and the Audit and Risk Committee the need, pro-actively acknowledged by management, for an additional focus in future years on both drivers of uncertainty; most particularly, in addressing the root causes of the tendency for delivery optimism. A key root cause is that for some projects – including many which are financially well-managed during their overall lifecycle – insufficient focus is placed on revising accruals estimates based on information emerging after the Balance Sheet date.

While in many respects capital accruals valuation follows straightforwardly from management information, my experience of these specific factors caused me to retain an additional focus to my work for 2019-20, as described below.

I assessed this key audit matter to be a significant risk for my audit.

How the scope of my audit responded to the risk

I substantively tested capital accruals after the completion of this process, allowing management sufficient time after the year end to revise accruals estimates based on actual delivery. In order to address any latent risk of delivery optimism, I ensured my sample selection included sufficient testing to provide a firmly grounded statistical extrapolation of the potential effect on the accounts. I also furthered my coverage and statistical confidence by testing the majority of accruals at project, rather than task line, level, and by taking a stratified approach based on value-based risk characteristics.

Furthermore, management performed additional work to evaluate the estimation uncertainty factors around contractor disputes. While neither I nor Network Rail expected material estimation uncertainty from this factor, I furthered my coverage by reviewing the methodology and source data connected with Network Rail's adjustment addressing disputes optimism.

Key observations
Having assessed the above exercise, I did not identify any material misstatements in the valuation of the capital accruals recognised, and disclosed, in the financial statements. Most projects were able to clearly and accurately substantiate their assumptions with regards to stages of progress, taking into account information available after the year-end to revise their accrual estimate where necessary. Any issues found were mostly clerical in nature.

First time adoption of IFRS 16 Leases

Description of risk

Network Rail implemented the new IFRS 16 'Leases' accounting standard this year. The new standard requires lessees to recognise nearly all leases on the Balance Sheet which will reflect their right of use of an asset for a period of time and the associated liability for the payments. Network Rail recognised a material balance of £410 million right of use assets and lease liabilities on transition.

The implementation was data-intensive, with Network Rail having to identify all applicable arrangements, collate data and make judgements, for example, on the appropriate incremental borrowing rate; and whether they are reasonably certain that break/extension clauses will be enacted to determine the lease term. Network Rail's interactions with suppliers take place both within central delivery units and the decentralised Regions, and due to the size and current number of related contracts within the organisation, I focussed my work most heavily on the risk that the analysis of IFRS 16 leases might be incomplete.

I assessed this key audit matter to be a significant risk for my audit.

How the scope of my audit responded to the risk

Completeness
I reviewed the process and controls that Network Rail implemented to capture and assess arrangements that could contain a lease. I then investigated high-risk areas of business using assets that could be leased, to better understand the contractual arrangements with third-parties. This was combined with a data-analytics led approach to sample contracts displaying high-risk lease-like attributes. These samples did not identify any issues, but supplementary work identified two omitted leases – immaterial in total – across the organisation.

Application and Judgements
Outside my heaviest focus on completeness, I performed a sample test of historical leases and in-year leases and reviewed management's judgements around lease term, including the relative certainty surrounding the use of break clauses. I also reviewed the appropriateness of the incremental borrowing rate.

Key observations
In the course of completing this work, I did not identify any material misstatements in the completeness of the lease assets and liabilities recognised, and disclosed, in the financial statements.

Application of materiality
I applied the concept of materiality in both planning and performing my audit, and in evaluating the effect of misstatements on my audit and on the financial statements. This approach recognises that financial statements are rarely absolutely correct, and that an audit is designed to provide reasonable, rather than absolute, assurance that the financial

Independent auditor's report continued

statements are free from material misstatement or irregularity. A matter is material if its omission or misstatement would, in the judgement of the auditor, reasonably influence the decisions of users of the financial statements.

Audited Area	Basis	Materiality
Overall Financial Statement Materiality (applying to all audited areas with the exception of those listed below)	Approximately 1 % of the rail network asset valuation	£500m
Account balances and transaction streams not connected with the valuation of the rail network asset and to support my opinion on regularity	Approximately 1 % of the group's total gross annual expenditure (operating and capital)	£100m

I consider the above benchmarks to reflect the principal considerations for the users of the accounts in assessing the financial performance and position of the group.

As well as quantitative materiality there are certain matters that, by their very nature, would if not corrected, influence the decisions of users, for example, any errors reported in the Directors' Remuneration Report. Assessment of such matters would need to have regard to the nature of the misstatement and the applicable legal and reporting framework, as well as the size of the misstatement.

I applied the same concept of materiality to my audit of regularity. In planning and performing audit work in support of my opinion on regularity and evaluating the impact of any irregular transactions, I took into account both quantitative and qualitative aspects that I consider would reasonably influence the decisions of users of the financial statements.

I agreed with the Audit and Risk Committee that I would report to it all uncorrected misstatements identified through my audit in excess of £1 million, as well as differences below this threshold that in my view warranted reporting on qualitative grounds.

Total unadjusted audit differences, including the effect of extrapolating sample-based errors to a most likely position, reported to the Audit and Risk Committee would decrease net assets by £1 million.

Responsibilities of the Directors for the financial statements

As explained more fully in the Directors' statement of responsibilities within the Directors' report, the directors are responsible for:

- the preparation of the group financial statements and for being satisfied that they give a true and fair view;
- such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
- assessing the group's and the parent's company's ability to continue as a going concern, disclosing, if applicable, matters relating to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (ISAs) (UK).

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs (UK), I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion – the risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the group and the parent company's internal control;

- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation; and,
- obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. I am responsible for the direction, supervision and performance of the group audit. I remain solely responsible for my audit opinion.

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

I also provide those charged with governance with a statement that I have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on my independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, I determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. I describe these matters in my auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in my report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

In addition, I am required to obtain evidence sufficient to give reasonable assurance that the income and expenditure reported in the financial statements have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Audit scope

The scope of my group audit was determined by obtaining an understanding of the group and its environment, including group-wide controls, and assessing the risks of material misstatement at the group level.

The Network Rail group has total assets of £75.6 billion. The majority of operations are within Network Rail Infrastructure Limited, whilst the obligations attaching to the legacy Debt Issuance Programme (used to finance the group until October 2014) reside in a separate legal entity, Network Rail Infrastructure Finance plc ('NRIF'). There are further small legal entities including a consultancy business and a company that manages the maintenance of non-owned stations. The Network Rail group is a consolidation of these legal entities.

I have audited the full financial information of Network Rail Infrastructure Limited and NRIF, as well as the consolidation. In respect of the debt and derivatives held by NRIF, my group audit takes account of both market-observable valuations for derivatives and a minority of fair-valued bonds, as well as assessing the application of the amortised cost basis to the remainder. This work covered substantially all of the group's assets and pre-tax results, and together with the procedures performed at group level in respect of non-significant components, gave me the evidence I needed for my opinion on the group financial statements as a whole.

During the course of my audit, in addition to the key audit matters highlighted above, I:

- reviewed the accounting for the disposal of the Core Valley Lines;
- considered the impact of the evolving changes Network Rail is making under the banner of 'putting passengers first'; and
- evaluated the group's judgements about the implementation of IFRS 16 Leases – in addition to my focussed work on completeness described in the key audit matter above – and worked with management to further develop disclosures.

Other Information

Directors are responsible for the other information. The other information comprises information included in the annual report, with the exception of the parts of the Directors' remuneration report described in that report as having been audited, the financial statements and my auditor's report thereon. My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon. In connection with my audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

Independent auditor's report continued

I am specifically required to address the following items and to report uncorrected material misstatements in the other information, where I conclude that those items meet the following conditions.

- *Fair, balanced and understandable:* the statement given by the directors that the annual report and accounts taken as a whole are fair, balanced and understandable and provide the necessary information to enable users to assess the entity's performance, business model and strategy, is materially inconsistent with my knowledge obtained in the audit.
- *Audit and Risk Committee reporting*: the section describing the work of the Audit and Risk Committee does not appropriately address matters communicated by me to that committee.

I also have nothing to report in this regard.

Opinion on other matters prescribed by the Companies Act

Directors' remuneration

In my opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

I also report to you if, in my opinion, certain disclosures of directors' remuneration required have not been made. I have nothing to report arising from this duty.

The strategic and directors' reports

In my opinion, based on the work undertaken in the course of the audit, the information given in the strategic and directors' reports for the financial year for which the financial statements are prepared is consistent with the financial statements and those reports have been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the group and the company and its environment obtained in the course of the audit, I have not identified any material misstatements in the strategic report or the directors' report.

The corporate governance statement

In my opinion, based on the work undertaken in the course of the audit:
- the information given in the Corporate governance report, in compliance with rules 7.2.5 and 7.2.6 in the Disclosure Rules and Transparency Rules sourcebook made by Financial Conduct Authority (the FCA Rules), in respect of internal control and risk management systems in relation to financial reporting processes, and about share capital structures, is consistent with the accounts and has been prepared in accordance with applicable legal requirements.
- rules 7.2.2, 7.2.3 and 7.2.7 of the FCA Rules about the group and the parent company's corporate governance code and practices and about its administrative, management and supervisory bodies and their committees have been complied with.

Based on my knowledge and understanding of the group and the parent company and their environments obtained during the course of the audit, I have identified no material misstatements in this information.

Matters on which I report by exception

Adequacy of accounting records information and explanations received

I report to you if, in my opinion:
- adequate accounting records have not been kept, or returns adequate for my audit have not been received from branches not visited by my staff;
- the financial statements and the part of the Remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made;
- I have not received all of the information and explanations I require for my audit; or
- a corporate governance statement has not been prepared by the parent company.

I have nothing to report arising from this duty.

Matthew Kay,
Senior Statutory Auditor

For and on behalf of the Comptroller and Auditor General (Statutory Auditor)
National Audit Office
157-197 Buckingham Palace Road
London, SW1W 9SP

20 July 2020

Income statement
for the year ended 31 March 2020

	Note	2020 Group £m	2019 Group £m
Revenue	3	**8,099**	**6,676**
Net operating costs	4	**(5,777)**	**(5,243)**
Operating profit	5	**2,322**	**1,433**
Property revaluation movements and profits on disposal		**3**	**363**
Profit from operations		**2,325**	**1,796**
Finance income	7	**7**	**11**
Other gains and losses	8	**213**	**220**
Finance costs	9	**(2,170)**	**(2,200)**
Profit / (Loss) before tax		**375**	**(173)**
Tax	10	**(395)**	**(52)**
Loss for the year attributable to the owner of the company		**(20)**	**(225)**

Under section 408 of the Companies Act 2006 the group has elected to take the exemption with regard to disclosing the company income statement. The company's result for the year was £nil (2019: £nil).

Statement of comprehensive income

for the year ended 31 March 2020

	Note	2020 Group £m	2019 Group £m
Loss for the year		**(20)**	**(225)**
Other comprehensive (expense)/income:			
Items that will not be reclassified to profit or loss			
(Loss) / gain on revaluation of the railway network	12	**(272)**	**2,632**
Actuarial (loss)/gain on defined benefit pension schemes	26	**742**	**(31)**
Deferred tax relating to components of other comprehensive income	22	**(180)**	**(443)**
Total items that will not be reclassified to profit or loss		**290**	**2,158**
Items that may be reclassified to profit or loss			
Gain/(Loss) on movement in fair value of cash flow hedge derivatives		**3**	**(5)**
Reclassification of balances in the hedging reserve to the income statement		**208**	**206**
Total items that may be reclassified to profit or loss		**211**	**201**
Other comprehensive income for the year		**501**	**2,359**
Total comprehensive income for the year		**481**	**2,134**

Statement of changes in equity

for the year ended 31 March 2020

Group	Revaluation reserve £m	Other reserve* £m	Hedging reserve £m	Retained earnings £m	Total equity £m
Balance at 31 March 2019	**2,912**	**249**	**(643)**	**6,390**	**8,908**
Loss for the year	-	-	-	(20)	(20)
Other comprehensive income					
Impact of change in tax rate	(70)	-	-	(19)	(89)
Revaluation of the railway network	(272)	-	-	-	(272)
Transfer of deemed cost depreciation from revaluation reserve	(62)	-	-	62	-
Decrease in deferred tax liability on the railway network	50	-	-	-	50
Actuarial gain on defined benefit pension schemes	-	-	-	742	742
Deferred tax on actuarial gain	-	-	-	(141)	(141)
Transfer of deferred tax	12	-	-	(12)	-
Increase in fair value of hedging derivatives	-	-	3	-	3
Reclassification of balances in hedging reserve to the income statement	-	-	208	-	208
Total comprehensive income	**(342)**	**-**	**211**	**612**	**481**
Balance at 31 March 2020	**2,570**	**249**	**(432)**	**7,002**	**9,389**

Balance at 31 March 2018	**751**	**249**	**(844)**	**6,618**	**6,774**
Loss for the year	-	-	-	(225)	(225)
Other comprehensive income					
Revaluation of the railway network	2,632	-	-	-	2,632
Transfer of deemed cost depreciation from revaluation reserve	(37)	-	-	37	-
Increase in deferred tax liability on the rail network	(447)	-	-	-	(447)
Actuarial loss on defined benefit pension schemes	-	-	-	(31)	(31)
Deferred tax on actuarial loss	-	-	-	4	4
Transfer of deferred tax	13	-	-	(13)	-
Decrease in fair value of hedging derivatives	-	-	(5)	-	(5)
Reclassification of balances in hedging reserve to the income statement	-	-	206	-	206
Total comprehensive income	**2,161**	**-**	**201**	**(228)**	**2,134**
Balance at 31 March 2019	**2,912**	**249**	**(643)**	**6,390**	**8,908**

* Other reserves of £249m (2019 £249m) include the vesting reserve on privatisation.

There has been no movement in the current or prior year affecting the statement of changes in equity for the company.

Balance sheets

at 31 March 2020

	Note	2020 Group £m	2019 Group £m	2020 Company £m	2019 Company £m
Assets					
Non-current assets					
Intangible assets	11	62	63	-	-
Right of use assets	24	428	-	-	-
Property, plant and equipment - the rail network	12	71,809	71,467	-	-
Investment property	13	227	232	-	-
Derivative financial instruments	20	474	340	-	-
Interest in joint venture	14	41	44	-	-
		73,041	**72,146**	**-**	**-**
Current assets					
Assets held for sale	15	24	10	-	-
Inventories	16	262	226	-	-
Trade and other receivables	17	1,877	1,739	-	-
Current tax assets		-	2	-	-
Derivative financial instruments	20	10	10	-	-
Cash and cash equivalents		430	450	-	-
		2,603	**2,437**	**-**	**-**
Total assets		**75,644**	**74,583**	**-**	**-**
Liabilities					
Current liabilities					
Trade and other payables	18	(3,637)	(3,406)	-	-
Borrowings	19	(10,781)	(11,557)	-	-
Derivative financial instruments	20	(48)	(52)	-	-
Short-term provisions	21	(80)	(64)	-	-
		(14,546)	**(15,079)**	**-**	**-**
Net current liabilities		**(11,943)**	**(12,642)**	**-**	**-**
Non-current liabilities					
Borrowings	19	(44,664)	(43,719)	-	-
Derivative financial instruments	20	(847)	(981)	-	-
Other payables	18	(548)	(326)	-	-
Retirement benefit obligation	26	(2,070)	(2,566)	-	-
Deferred tax liabilities	22	(3,580)	(3,004)	-	-
		(51,709)	**(50,596)**	**-**	**-**
Total liabilities		**(66,255)**	**(65,675)**	**-**	**-**
Net assets		**9,389**	**8,908**	**-**	**-**
Equity					
Revaluation reserve		2,570	2,912	-	-
Other reserve		249	249	-	-
Hedging reserve		(432)	(643)	-	-
Retained earnings		7,002	6,390	-	-
Total shareholder's funds and equity attributable to equity holders of the parent company		**9,389**	**8,908**	**-**	**-**

The financial statements and accompanying disclosure notes on pages 132 to 176 were approved by the board of directors on 16 July 2020 and authorised for issue on 21 July 2020.

They were signed on its behalf by:

Andrew Haines
Chief executive

Jeremy Westlake
Chief financial officer

Company registration number: 4402220

Statement of cash flows
for the year ended 31 March 2020

	Note	2020 Group £m	2019 Group £m	2020 Company £m	2019 Company £m
Cash flows from operating activities					
Cash generated from operations	23	4,923	3,622	-	-
Interest paid*		(1,448)	(1,634)	-	-
Income tax received		3	–	-	-
Net cash generated from operating activities		**3,478**	**1,988**	**-**	**-**
Investing activities					
Interest received		7	11	-	-
Purchases of property, plant and equipment		(5,781)	(6,726)	-	-
Proceeds on disposal of property		534	1,469	-	-
Capital grants received		2,326	679	-	-
Net cash inflows / (outflows) from joint ventures		3	(9)	-	-
Net cash used in investing activities		**(2,911)**	**(4,576)**	**-**	**-**
Financing activities					
Repayments of borrowings		(12,304)	(4,597)	-	-
New loans raised		11,559	6,688	-	-
Decrease in collateral posted	19	193	23	-	-
Increase / (Decrease) in collateral held	19	82	(49)	-	-
Repayment of lease liabilities	24	(117)	–	-	-
Net cash (used in) / generated from financing activities		**(587)**	**2,065**	**-**	**-**
Net decrease in cash and cash equivalents		**(20)**	**(523)**	**-**	**-**
Cash and cash equivalents at beginning of the year		450	973	-	-
Cash and cash equivalents at end of the year		**430**	**450**	**-**	**-**

* Balance includes the net interest on derivative financial instruments

Notes to the financial statements
for the year ended 31 March 2020

1. General information

Network Rail Limited ('the company') is a company limited by guarantee which is incorporated and domiciled in Great Britain and registered in England and Wales under the Companies Act 2006. Network Rail Limited is an arm's length body of the Department for Transport.

The company registration number is 4402220.

The company's registered office is situated at 1 Eversholt Street, London NW1 2DN, United Kingdom.

The company's and its subsidiaries' (together 'the group' or 'Network Rail') principal activities are detailed in the 'About us' section on pages 5 to 11.

Network Rail is organised as a single operating segment for financial reporting purposes.

The Secretary of State is the sole member of the Company.

2. Significant accounting policies

Basis of accounting

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

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

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

Adoption of new and revised standards

The accounting policies adopted in this set of financial statements are consistent with those set out in the annual financial statements for the year to 31 March 2019; except for the changes in accounting standards noted below.

The following accounting standards have become effective in the current year and were adopted and applied by the group

IFRS 16 'Leases'

In the current year, the group has applied IFRS 16 'Leases', effective for periods commencing 1 January 2019 and was therefore effective from 1 April 2019 in Network Rail's accounts. IFRS 16 establishes principles for the recognition, measurement, presentation and disclosure of leases, with the objective of ensuring that lessees and lessors provide relevant information that faithfully represents those transactions.

Network Rail have applied the modified retrospective transition approach and have therefore not restated comparative amounts for the prior year. This transition method allows for the lease liability to be based on the remaining payments, and then sets the right-of-use asset as an amount equal to lease liability (adjusted for any accrued or prepaid amounts recognised under IAS 17). Therefore, there was no impact on equity at the date of initial application.

The following exemptions have been elected with the adoption of IFRS16:
- Elect not to measure leases that terminate within 12 months of the date of transition to IFRS16.
- Elect not to measure leases where the underlying asset is of low-value (<£5,000).
- Exclude initial direct costs from the measurement of right-of-use assets.
- Elect to use hindsight to determine lease term (e.g. in determining the lease term if options exist).
- Elect to take forward the previous identification of a lease applying IAS 17 and IFRIC 4 at the start of the relevant accounting period, also known as 'grandfathering'

The impact of the standard is to bring on balance sheet all the leases that had previously been accounted for as operating leases.

The following key judgements have been made by management regarding both the recognition as well as calculation of leases under IFRS 16:
- The incremental borrowing rate (2.245 %) has been used to calculate the right of use asset and lease liability unless the implicit rate can reliably be determined in the contract.
- Where practically possible lease components have been separated from the larger contracts to calculate the right of use asset. This is especially notable in contracts which contain embedded leases.
- The lease term has been set as the non-cancellable period of the lease together with options to extend or terminate a lease, if Network Rail are reasonably certain to exercise that option. Network Rail have made judgements as to whether they are reasonably certain to exercise the options, drawing on future business plans extant at period end. This judgement is reassessed at each reporting date.

IFRS 16 - Impact on adoption
On adoption of IFRS 16, the group recognised lease liabilities in relation to leases which had previously been classified as 'operating leases'

2. Significant accounting policies continued

under the principles of IAS 17 Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the incremental borrowing rate as of 1 April 2019.

The application of IFRS 16 at 1 April 2019 resulted in the recognition of Right of use (ROU) assets of £410m and Lease liabilities of £410m.

The following is a reconciliation of total operating lease arrangements disclosed in Note 24 of the March 2019 annual report and accounts amounting to £319m and the £410m lease liability recognised on adoption of IFRS 16 on 1 April 2019:

	Property leases £m	Non property leases £m	Total £m
Total operating lease commitments disclosed at 31 March 2019	238	81	319
Additional IAS 17 leases identified in transition to IFRS 16	63	77	140
Discounted using incremental borrowing rate	(74)	(12)	(86)
Change in assumptions	21	16	37
Total lease liabilities recognised under IFRS 16 at 1 April 2019	**248**	**162**	**410**

Where the group is a lessor, IFRS 16 has had no impact on the group. The group's leases where it acts as lessor meet the criteria to be accounted for as operating leases and hence the treatment is the same as was being applied under IAS 17. Rental income from operating leases and initial direct costs are recognised on a straight-line basis over the term of the relevant lease.

The following accounting standards have not been early adopted by the company but will become effective in future years:

IFRS 17 Insurance Contracts

IFRS 17 has been adopted by the IASB for periods beginning on or after 1 January 2023 and has not currently been endorsed by the EU. Management have not yet considered the impact of the standard on Network Rail.

Going concern

The group's business activities, together with the factors likely to affect its future development, performance and position are set out in the 'About us' section on pages 5 to 11, and 'Business unit summaries' on pages 23 to 50. The financial position of the group, its cash flows, liquidity position and borrowing facilities are described in the Chief Financial Officer's review on pages 17 to 21.

The group has considerable financial resources together with long-term contracts with a number of customers and suppliers. Network Rail does not expect to undertake any new borrowing in the next 12 months. Instead it's activities will be largely funded by grants from the Department for Transport and revenue from customers. Network Rail has secured a £31.9bn loan facility with the Department for Transport (DfT), which it intends to draw upon to specifically refinance its' existing debt with DfT legacy commercial borrowing. This facility remains within its parameters.

Network Rail has eight separate grant agreements in place with DfT and Transport Scotland (TS) to fund activities in the next 12 months. These grants are: - with DfT - Network Grant; Enhancements Grant; British Transport Police Grant; Financing Costs Grant for DfT interest; Financing Costs Grant for external interest (bonds and swaps); and Corporation Tax Grant - with TS - Network Grant and Enhancements Grant.

Business plans and financial models are used to project cash flows and monitor financial risks and liquidity positions, forecast future funding requirements and other key financial ratios, including those relevant to our network licence. Analysis is undertaken to understand the resilience of the group and its business model to the potential impact of the group's principal risks, or a combination of those risks. This analysis takes account of the availability and effectiveness of the mitigating actions that could realistically be taken to avoid or reduce the impact or occurrence of the underlying risks. The board considers the likely effectiveness of such actions through regular monitoring and review of risk management and internal control systems. Further details are set out in the Viability Statement on pages 70 and 71. In addition, Note 25 to the accounts includes the group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit, liquidity and foreign exchange risk.

After making enquiries, including those detailed above, the directors have a reasonable expectation that the company and the group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

Basis of consolidation

Subsidiaries are all entities (including structured entities) over which the group has control. The group controls an entity when the group is exposed to, or has rights to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Transactions with non-controlling interests that do not result in a loss of control are accounted for as equity transactions. In terms of subsidiaries the group:

- Consolidates subsidiaries from the date on which control passes to the group and deconsolidates from the date control ceases;
- Changes the accounting policies of subsidiaries, where necessary, to ensure consistency with the policies adopted by the group;
- Eliminates intercompany transactions and balances in the group results.

Notes to the financial statements continued

2. Significant accounting policies continued

Revenue recognition

The group recognises revenue from the following major sources:

- Grant income – recognised in accordance with IAS 20;
- Franchised network access – recognised in accordance with IFRS 15;
- Freight revenue - recognised in accordance with IFRS 15;
- Property rental income – recognised in accordance with IFRS 16 (See "Leases" accounting policy); and
- Other income – recognised in accordance with IFRS 15.

Network Rail's grant income is recognised in line with IAS 20 'Accounting for Government Grants' – refer to 'Grants' accounting policy.

Network Rail's recognition approach is to recognise franchised network access and freight revenue each period in the financial year.

Performance obligations are based upon fixed and variable volume access to the railway during the relevant year. Performance obligations are satisfied by providing track access over time as per agreement with the train operating companies. There are no significant judgments applied to determine whether performance obligations have been satisfied. The input method is applied based on time lapsed.

Other income consists of Non Franchised fixed and variable network access which will be recognised using the same policy as for Franchised Network access.

Revenue is measured based on consideration specified in a contract with a customer and excludes amounts collected on behalf of third parties. Revenue represents amounts derived from the management and provision of assets for use in the operation of the railway and property rental income net of value added tax. Amounts recognised take account of any performance penalties or bonuses in respect of the year. The performance penalties and bonuses are estimated in each 4 week period based on that period's performance and reflect management's best estimate of the amounts due.

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

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

Separate accounting policies have not been adopted for revenue related contract assets / liabilities (deferred income), as the impact of IFRS 15 classification, recognition and measurement is insignificant.

Grants

Network Rail receives grant funding as a contribution towards both its revenue and capital expenditure.

Revenue Grants are received as a contribution towards Network Rail's running costs. These grants are drawn down by Network Rail against grant agreements based on forecast cash flows of relevant expenditure and are deferred until that expenditure is incurred. Deferred grant income is then credited to revenue on a systematic basis during the period in which Network Rail recognises the related costs as expenses for which the grants are intended to compensate.

Capital Grants are received as contributions towards the cost of property, plant and equipment from DfT, Transport Scotland (TS) and Third Parties. Network Rail draws down Capital Grants from DfT and TS based on historical costs incurred in order to meet future forecasts cash flows. Third Parties are invoiced for Capital Grants either in advance or arrears based on individual grant agreements. Capital Grants are recognised in the same period as the additions they are intended to fund and are deducted from the fair value of those assets. Capital grants are then credited to the income statement over the economic useful life of the rail network as the related costs are recognised.

Leases

The group as lessor

The group assesses leases where it is lessor in order to determine whether the lease is an operating lease or a finance lease. This assessment is made where the group owns the asset being leased or the group itself is also leasing the asset and hence the lease being assessed is a sub-lease. The assessment considers whether the lease transfers substantially all of the risks and rewards incidental to ownership of the asset being leased. Where the lease is a sub-lease, this assessment is made by reference to the Right of Use asset the group has for the head-lease. If the lease transfers substantially all of the risks and rewards incidental to ownership, then the lease is classified as a finance lease. If it does not, then the lease is classified as an operating lease.

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

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

2. Significant accounting policies continued

The group as lessee

For those leases of not less than 12 months or low value, the ROU asset and Lease liability are initially measured on a present value basis.

The present value of the following lease payments is used to determine the value of the lease liability:

- fixed payments less any lease incentive receivable;
- variable lease payments that depend on an index or a rate;
- amounts expected to be payable by the Group under residual value guarantees;
- the exercise price of a purchase option if the Group is reasonably certain to exercise that option; and
- payments of penalties for terminating the lease, if the lease term reflects the Group exercising that option.

The lease liability is subsequently measured at amortised cost using the effective interest rate method. Remeasurement of the lease liability occurs if there is a change in the lease payments (when a corresponding adjustment is made to the ROU asset), the lease term or in the assessment of an option to purchase the underlying asset.

The discount rate used to discount the lease payments is the Group's incremental borrowing rate. This is the rate that the group would have to pay to borrow similar funds to fund a similar asset. ROU assets are initially measured at the same amount as the lease liability plus any initial direct costs.

Each ROU asset is depreciated over the shorter of its useful life and the lease term on a straight-line basis.

Payments associated with short-term leases and low value leases are recognised on a straight-line basis as an expense in profit or loss.

Foreign currencies

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

Borrowing costs

In the prior year, borrowing costs directly attributable to the construction of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use, were added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs were recognised in the income statement in the period in which they are incurred. In the current year, all borrowing costs are recognised in the income statement in the period in which they are incurred.

Operating profit

Operating profit is stated before finance income, finance costs, other gains and losses, and revaluation movements and profits on disposal of properties.

Retirement benefit costs

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

For the defined benefit schemes, the cost of providing benefits is determined using the projected unit credit method, with full actuarial valuations being carried out at least every three years and updates to these valuations carried out in intervening years. The current service cost and plan administration expenses are recognised as an operating expense in the consolidated income statement.

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

The net interest cost is the charge in the year on the net defined benefit liability. The charge reflects the passage of time and is recognised as a finance cost in the income statement.

Past service cost and credits are recognised immediately in the consolidated income statement.

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

The group reflects its share of the deficit in the financial statements. The IAS 19 deficit, service cost and interest cost therefore represent 60 per cent of the total for each of the schemes. Further details on the retirement benefit schemes are provided in note 26.

Research and development

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

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

2. Significant accounting policies continued

Tax

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

Current tax is based on the taxable results of the group and calculated in accordance with tax rules in the United Kingdom.

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

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

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

Property, plant and equipment – the rail network

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

Valuation methodology
The rail network is carried in the balance sheet at its fair value. As there is no active market in railway infrastructure assets, the company has derived the fair value of the rail network using an income approach. The income approach assesses the discounted future cash flows that are expected to be generated by the rail network, including an assessment of under and outperformance against the current 5-year regulatory determination.

This valuation is carried out twice a year and revaluation gains and losses are reflected in other comprehensive income.

Depreciation
The rail network is depreciated on a straight-line basis over its estimated weighted average remaining useful economic life. The estimated weighted average remaining useful economic life of the network is currently 40 years (2019: 40 years). The remaining useful economic lives of network assets are estimated annually, with external verification of the valuation and asset lives carried out where required.

Capitalisation of operating costs
In line with IAS 16 Property, plant and equipment all directly attributable costs necessary to deliver the investment programme are capitalised. Employee and other associated costs are capitalised if they arise directly as a result of delivering the investment programme.

Presentation of capital grants
Grants and other contributions received towards the cost of property, plant and equipment are deducted from the fair value of assets which the grant funding relates to. See Note 12. Property, plant and equipment – the rail network for detail of the gross and net values of capital grants included in the property, plant and equipment balance.

Investment property

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

Intangible assets

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

Assets held for sale

Non-current assets are classified as held for sale if it is highly probable that they will be recovered primarily through sale or distribution rather than through continuing use.

Immediately before classification as held for sale, the assets are re-measured in accordance with the accounting policies for the asset category. Subsequently, the assets are held at the lower of carrying value and fair value less costs to sell. Any impairment loss on a disposal group is recognised immediately in the income statement.

2. Significant accounting policies continued

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

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

Financial assets
Financial assets at amortised cost
Financial assets are classified as at amortised cost where the business model is to hold assets in order to collect contractual cash flows, and the cash flows consist solely of payments of principal and interest (SPPI) on the principal amount outstanding.

Trade receivables do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts, recognised in the income statement.

Financial assets at FVTPL
Financial assets are classified as at FVTPL where the asset does not meet the amortised cost criteria or if doing so, eliminates or significantly reduces or eliminates a measurement or recognition inconsistency. Gains and losses arising from changes in fair value of these assets are recognised in the income statement.

Impairment of financial assets
Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets at FVTPL are stated at fair value with any resultant gain or loss recognised in the income statement.

Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been reduced.

The carrying amount of the financial asset is reduced by the impairment loss for all financial assets with the exception of trade receivables, which are reduced by allowances for irrecoverable amounts. As financial assets, trade receivables are subject to the "Expected Credit Loss model" under IFRS 9. The group's exposure to credit risk is limited largely to property rental income, and no significant increase in credit risk has materialised. Therefore, the group has continued to recognise 12 month expected losses that are updated at each reporting date, in the form of allowances for irrecoverable amounts, which approximate the expected losses for the next 12 month period.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income statement. The reversal is only made to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Cash and cash equivalents
Cash and cash equivalents comprise bank balances held by the group and commercial paper at varying rates. The carrying amount of these assets approximates their fair value.

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

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

Financial liabilities at FVTPL
Financial liabilities are classified as at FVTPL where the financial liability is a derivative financial liability or designated at FVTPL at initial recognition.

A financial liability is designated as FVTPL upon initial recognition if such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise exist.

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

Debt
Debt instruments not designated at FVTPL are initially measured at fair value, net of discount and direct issue costs, and subsequently recognised at amortised cost using straight line amortisation as a proxy for the IFRS 9 effective interest rate method. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an accrual basis to the income statement using the effective interest rate method, and are added to the carrying value of the debt instrument to the extent that they are not settled in the period in which they arise.

Notes to the financial statements continued

2. Significant accounting policies continued

Certain bonds, as set out in Note 19, are designated at FVTPL. These bonds are hedged by derivative financial instruments as part of a documented risk management strategy. By recognising these bonds and derivatives at FVTPL the recognition inconsistencies that would otherwise exist with regard to these risk management strategies are significantly reduced.

Trade payables

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

Derivative financial instruments and hedge accounting

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

Almost all the hedged events have now occurred and there will be no new hedging programme. Under IFRS 9, the group have opted to continue to apply the hedge accounting requirements of IAS 39 until the hedging programme is finalised.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each balance sheet date. Derivatives are presented on the balance sheet in line with their maturity date.

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

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

Cashflow hedge accounting is discontinued when the hedging instrument expires, is sold, terminated, exercised or no longer meets the criteria for hedge accounting. Where the hedging instrument no longer meets the criteria for hedge accounting, the cumulative gain or loss on the hedging instrument that remains recognised directly in equity from the period when the hedge was effective remains in equity until the forecast transaction occurs.

In the instance where cashflow hedge accounting is discontinued since the forecast transaction is no longer expected to occur, the cumulative gain or loss on the hedging instrument that remains recognised directly in equity from the period where the hedge was effective is recognised in the income statement.

Embedded derivatives within a financial asset host contract are not separated from the host contract, instead, the whole contract in its entirety is accounted for as a single financial instrument.

Embedded derivatives within a host contract that is a financial liability are separated from the host contract and accounted for as a derivative financial instrument when economic characteristics of the embedded derivative and host are not closely related, an identical instrument (with the same terms) would meet the definition of a derivative, and the entire contract is not measured at fair value through profit or loss. Gains or losses from the movement in fair value of the financial instrument are reported in the income statement. There are no separated embedded derivatives included in the financial statements.

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

Cash flow hedges

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

Provisions

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

Critical accounting judgements and key sources of uncertainty

(i) Property, plant and equipment – the rail network: the estimate of the fair value of the rail network is based on an income approach using the regulatory asset base, which equates to the discounted future cash flows associated with the network, adjusted for the net present value of any variances from the Office of Rail and Road's determination using the building block model of regulation.

The most significant judgement underpinning the valuation is that the regulatory framework and associated cash flows remain sufficiently stable and robust to form the basis of a third party valuation. Management assess that based on the current regulatory environment, an

2. Significant accounting policies continued

investor could reasonably expect to recover the RAB value through the revenue deriving from future amortisation allowances and the regulatory return thereon. In its assessment management has considered the amendments to the regulatory framework that are set out in the regulator's determination for Control Period 6 (2019-2024), and noted that although the regulated asset base has ceased to be a building block in the determination of the company's revenue requirement, the link between income and the regulated asset base would be reinstated in the event that the rail network asset were transferred to a private owner.

Management have also considered whether the portfolio of assets held for sale should continue to be deducted against the RAB in arriving at the fair value of the rail network, and based on an assessment of likely regulatory action in the event of a sale, have concluded that this remains appropriate. Further detail on this and other key judgements applied in the valuation are set out in Note 12.

The key source of estimation uncertainty within the valuation is the assessment of future performance against the regulatory determination which is discussed in more detail in Note 12.

Whilst not affecting the fair value of the asset recognised at the balance sheet date, management's assessment of the remaining life of the asset affects the depreciation that is charged on the asset, is also an area of estimation uncertainty. IAS 16 requires that management regularly review asset lives on at least an annual basis and that that depreciation is charged on a systematic basis that reflects the way the asset is consumed. In March 2019 Network Rail produced a detailed and rigorous depreciated replacement cost (DRC) valuation of the rail network for inclusion in DfT's group accounts. In preparing these financial statements management reviewed the weighted average remaining asset lives as produced in the DRC valuation and concluded that it is still appropriate to use 40 years as the weighted average remaining life.

Cost of Work Done (COWD): The additions to Property, plant and equipment are valued using an estimate of the cost of work done in the year to 31 March. To the extent that the COWD is greater than the invoiced amount, a PPE addition and 'other payable' (Note 18) are recognised on the basis of expected amounts required to settle contractual obligations. COWD assessments are predominantly based on information readily available to project managers on the status of works, but some estimation uncertainty is involved in the year-end measurement, in respect of the evaluation of how contractual dispute positions are likely to resolve, and in measuring the value of works performed at the precise year end date.

(ii) Investment property – an element of the investment property portfolio valuation is determined using the Beacon method. Jones Lang LaSalle provided their assessment of yields for 18 classes of property and areas in the portfolio. These are then used to produce income multipliers and applied to the rental streams from each of the individual properties in the portfolio to form an overall valuation. For investment property transferred to assets held for sale this is also the inherited method of valuation. Further details are set out in Note 13.

(iii) Retirement benefit obligations – the group recognises and discloses its retirement benefit obligation in accordance with the measurement and presentational requirement of IAS 19 (Revised) 'Employee Benefits'. The calculations include a number of judgements and estimations in respect of the expected rate of return on assets, the discount rate, inflation assumptions, the rate of increase in salaries and life expectancy among others. Changes in these assumptions can have a significant effect on the value of the retirement benefit obligation. The key assumptions made are set out in Note 26. The total contribution rate payable under the Railway Pension Scheme (RPS) and the Career Average Revalued Earnings (CARE) scheme is normally split in the proportion 60:40 between the group and the members, respectively. The group reflects its share of the contribution in the financial statements.

(iv) Taxation – the group recognises and discloses its deferred tax assets in accordance with IAS 12. Where it is considered to be probable that deferred tax assets can be matched to future taxable profits then deferred tax assets are recognised, or offset against the overall deferred tax provision as appropriate. This evaluation requires significant judgements to be made, including the uncertainty of the availability of future taxable profits. Further details are set out in Note 10.

Notes to the financial statements continued

3. Revenue

	2020 Group £m	2019 Group £m
Grant income	5,259	4,125
Franchised network access	2,507	2,143
Freight revenue	43	58
Property rental income	254	317
Other income	36	33
Revenue	**8,099**	**6,676**

The effect of the performance regimes was a net loss of £30m (2019: net loss of £439m) which led to a reduction in revenue of the respective amount.

4. Net operating costs

	2020 Group £m	2019 Group £m
Employee costs (see Note 6)	2,715	2,561
Own costs capitalised	(1,091)	(1,055)
Other external charges (including infrastructure maintenance costs)	2,613	2,435
Other operating income and recoveries	(313)	(364)
Net operating costs before depreciation and amortisation	**3,924**	**3,577**
Depreciation (see Notes 12 and 24)	2,022	1,810
Amortisation of grants	(169)	(144)
Net operating costs	**5,777**	**5,243**

5. Profit from operations

Total profit from operations is stated after charging/(crediting):

	2020 Group £m	2019 Group £m
Research and development costs expensed	4	-
Amortisation of intangible assets	1	1
Profit on sale of properties	-	(328)
Increase in the fair value of investment properties	(3)	(35)
Cost of inventories recognised as an expense	243	220
Write down of inventories recognised as an expense	6	3

Amounts payable to auditors		
Fees payable to the company's auditors for the audit of the company and consolidated financial statements	0.46	0.43
Fees payable to the company's auditors for audit related services:		
– The audit of the company's subsidiaries	0.05	0.09
– Regulatory accounts audit and interim review	0.06	0.07
Total amounts payable to group auditors	**0.57**	**0.59**

For financial years ended 31 March 2020 and 2019 no fees were payable to the company's auditors in respect of non-audit related services. In addition to the audit fee information given in the table the group pays £0.2m for the audit of subsidiaries that are not performed by the group auditor.

6. Employee costs

The monthly average number of employees (including executive directors) was:

	2020 Group Number	2019 Group Number
Management and operation of the railway	**42,099**	**40,268**

	2020 Group £m	2019 Group £m
Their aggregate remuneration comprised:		
Wages and salaries	2,168	2,050
Social security costs	241	227
Defined contribution pension costs (see Note 26)	23	20
Defined benefit pension costs – current service costs (see Note 26)	283	257
Defined benefit pension costs – past service costs (see Note 26)	-	7
Total employee costs	**2,715**	**2,561**

In the years ended 31 March 2020 and 31 March 2019 key management personnel were all the executive directors and the chair of the board of directors. Full details of their remuneration are included within the annual remuneration report on pages 103 to 112.

7. Finance income

	2020 Group £m	2019 Group £m
Interest receivable on investments and deposits	**7**	**11**
	7	**11**

Finance income earned on financial assets analysed by category of asset, is as follows:

	2020 Group £m	2019 Group £m
Financial assets at amortised cost (including cash and bank balances)	**7**	**11**
	7	**11**

Notes to the financial statements continued

8. Other gains and losses

	2020 Group £m	2019 Group £m
Net ineffectiveness arising from cash flow hedge accounting	(19)	(7)
Fair value loss on fair value hedges	-	(220)
Fair value gain on carrying value of fair value hedged debt	-	226
Gain arising from fair value hedge accounting	**-**	**6**
Net increase in fair value of non-hedge accounted debt	(4)	(3)
Gain on derivatives not hedge accounted	236	224
Gain arising from non-hedge accounting	**232**	**221**
Total other gains	213	220

No other gains and losses have been recognised in respect of financial assets or liabilities other than those disclosed in this note. No gains or losses have been recognised on financial liabilities measured at amortised cost other than those disclosed in Note 9.

The movement in fair value of debt designated as fair value through profit and loss and exchange differences on retranslation of foreign currency debt that form part of the above total other gains and losses are in relation to debt issuances disclosed in Note 19.

9. Finance costs

	2020 Group £m	2019 Group £m
Interest on bank loans and overdrafts	16	8
Interest on loan issued by Department of Transport	688	674
Interest on bonds issued under the Debt Issuance Programme	1,163	1,148
Interest on derivative instruments	230	232
Defined benefit pension interest cost (see note 26)	58	55
Debt Issuance Programme financial indemnity fee	-	266
Lease interest payable (Note 24)	15	-
Total borrowing costs	**2,170**	**2,383**
Less: capitalised interest	-	(183)
Total finance costs	**2,170**	**2,200**

10. Tax

The tax credit is made up as follows:

	2020 Group £m	2019 Group £m
Current tax:		
Corporation tax charge	-	-
Adjustment in respect of prior years	-	1
Total current tax credit	**-**	**1**
Deferred tax:		
Current year charge	(107)	(53)
Effect of rate change	(265)	-
Adjustment in respect of prior years	(23)	-
Total deferred tax charge	**(395)**	**(53)**
Total tax charge	**(395)**	**(52)**

The tax charge for the year can be reconciled to the profit per the income statement as follows:

	2020 Group £m	2019 Group £m
Profit/(Loss) before tax	375	(173)
Tax at the UK corporation tax rate of 19 per cent (2019: 19 per cent)	(71)	33
Adjustments in respect of prior years	(23)	(1)
Rate changes	(265)	-
Income not subject to tax	(39)	(43)
Derecognition of tax assets – brought forward	2	-
De-recognition of deferred tax assets recognised in the year	-	(40)
Utilisation of tax losses previously derecognised	1	(1)
Total tax charge/(credit) for the year	**(395)**	**(52)**

Under IAS12 deferred tax assets can only be recognised where it is probable that taxable profits will be available against which the deferred tax asset can be utilised. As in 2019, it remains improbable that Network Rail will produce a level of taxable profits that will allow for recognition of a deferred tax asset relating to the trading losses carried forward. Additionally, whilst taxable income does not exceed allowable deductions in the year, Network Rail claims only the capital allowances sufficient to claim for group relief and available tax credits. The deferred tax asset on tax losses of £3,142m (2019: £3,144m) and surplus advanced corporation tax of £36.9m (2019: £36.9m) have not been recognised as it has not been possible to forecast future profits with sufficient certainty.

Deferred tax at 31 March 2020 is calculated at a rate of 19 per cent (2019: 17 per cent) based on tax rate expected to prevail based on legislative enactments at the point temporary differences resolve. The amount at which temporary differences crystallise is sensitive to the decisions on future tax laws to be taken by Parliament.

UK corporation tax is calculated at 19 per cent (2019: 19 per cent).

Notes to the financial statements continued

11. Intangible assets

Group	Concession £m
Cost	
At 1 April 2018, 31 March 2019 and 31 March 2020	78
Accumulated amortisation	
At 31 March 2018	**(14)**
Charge for the year	(1)
At 31 March 2019	**(15)**
Charge for the year	(1)
At 31 March 2020	**(16)**
Carrying amount	
At 31 March 2020	**62**
At 31 March 2019	**63**

The intangible assets above relate to separable economic rights associated with the concession to run the operations, maintenance and renewal business of the Channel Tunnel Rail Link, and are held by the wholly owned company Network Rail (High Speed) Limited.

Intangible assets are being amortised over the life of the licence of 83 years to 2086. Amortisation is charged to net operating costs in the income statement.

12. Property, plant and equipment – the rail network

	Group assets £m	Group capital grants deferred £m	Group carrying value £m
Valuation			
At 31 March 2018	**68,398**	**(4,256)**	**64,142**
Additions	7,043	-	7,043
Capital grant additions	-	(637)	(637)
(Depreciation charge)/grant amortisation for the year	(1,810)	97	(1,713)
Revaluation in the year	2,632	-	2,632
At 31 March 2019	**76,263**	**(4,796)**	**71,467**
Additions	5,176	(2,247)	2,929
Disposals	(517)	-	(517)
Transfers to held for sale	(23)	-	(23)
(Depreciation charge)/ grant amortisation for the year	(1,937)	162	(1,775)
Revaluation in the year	(272)	-	(272)
At 31 March 2020	**78,690**	**(6,881)**	**71,809**

Given the economic and physical interdependency of the assets comprising the rail network, the company has concluded that the rail network is considered as a single class of asset. The rail network is carried at its fair value.

As there is no active market in railway infrastructure assets, the company has derived the fair value of the rail network using an income approach. Under this approach the cash flows that a network licence holder expects to generate from the rail network are assessed using a market rate of return. This valuation is carried out twice a year and revaluation gains and losses are reflected in other comprehensive income.

The independent rail regulator, the Office of Rail and Road (ORR), stated (in the 2018 periodic review final determination: Supplementary document – financial framework) that a private network licence holder of the railway network would have its revenue requirement determined using the building block model of regulation. Under this model the network licence holder's annual income (received in the form of the network grant and track access charges) would comprise:

a) The regulator's assessment of the efficient costs of operating and maintaining the network
b) An allowance for Regulatory Asset Base (RAB) amortisation – qualifying capital expenditure is added to the RAB as incurred and recovered by the company through future amortisation allowances (in order to spread the cost to customers and stakeholders of investment in the rail network over many years).
c) An allowed return on the RAB – calculated by applying the rate of return permitted by the ORR (based on its assessment of the market's cost of capital) to the RAB balance.

In the determination for Control Period 6 (2019-2024), published on 31 October 2018, ORR explained that from 1 April 2019 the RAB ceased to be a building block in the determination of the company's revenue requirement, but that the previous method of revenue determination would be restored if the rail network asset were to be transferred to a private owner. IFRS 13 Fair Value Measurement requires management to assess fair value from the perspective of a theoretical market participant, rather than on the basis of the value-in use. Accordingly, the amendments made to the regulatory framework for Control Period 6, which reflect the proximity of Network Rail to the public sector and which would not apply to a market participant, are not relevant to the valuation.

Future cash flows under (a) are assumed to be equivalent over time to the network licence holder's actual costs of operation and maintenance, on the basis that the Regulator aims to set targets which are ambitious but achievable. These therefore have no net impact on forecast future cash flows, or the valuations. The allowed return (c) is based on a cost of capital which would be offset in a discounted future cash flows model (see Discount rate below). The economic rights inherent in ownership of the regulated rail network asset are therefore vested primarily in the value of the RAB, which will be recovered through future regulated income as the RAB is amortised (b).

This means that it is possible for the RAB itself to be used as the starting point for a discounted cash flow valuation. The RAB fluctuates in valuation; increasing in value principally as a result of allowances for capital expenditure and inflation indexation, whilst reducing for amortisation. The adjustments may give rise to upwards or downwards revaluations. Further changes are subject to:

a) Adjustment for any difference between regulatory rate of return and the market cost of capital that a third party investor would use to assess the value of the network (the rate of return and market cost of capital are currently assessed as fully aligned); and
b) Adjustment for forecast future under or out performance against the regulatory determination over the remainder of the current control period. No adjustment is made in respect of future control periods on the expectation of the Regulator setting, over the long term, ambitious but achievable determination. See forecast performance variation below.

When valuing the network, management is required to consider the value a knowledgeable willing party would place on the network in an arm's length transaction. On the grounds that third party investors are known to value the assets of regulated companies by reference to the RAB, and that the cash flows associated with the regulatory framework are considered sufficiently stable and robust to form the basis of a third party valuation, management has used the RAB as the starting point for its valuation.

Notes to the financial statements continued

12. Property, plant and equipment – the rail network continued

Third party funding

Additions to the railway network funded by capital grant, rather than via the RAB funding mechanism, are included in the valuation at cost. The carrying value of property, plant and equipment is calculated after netting off associated grant funding received or receivable.

Disposals

The group recorded £517m of disposals in the year. On 28 March 2020 the transfer of the Core Valley Lines assets to Transport for Wales completed for £470m consideration. The funds received were repaid against the Department for Transport borrowings (Note 19). The remaining disposals of £47m were as the result of property sales in the usual course of business. In line with Regulatory Accounting Guidelines the net proceeds of sales are deducted from the RAB, reducing the valuation of the Railway Network Valuation. The valuation of the disposals is assessed as being equal to the reduction in the valuation of the Railway Network relating to property sales and the transfer of the Core valley Lines to Transport for Wales.

Depreciation

The depreciation charge for any year is calculated using the average carrying value for the year and the estimated remaining weighted average useful economic life of the rail network. The remaining weighted average useful economic life of the rail network was calculated using the engineering assessment of serviceable economic lives of the major categories that comprise the rail network. The estimated remaining weighted average useful economic life of the network is currently 40 years (2019: 40 years).

Discount rate

The discount rate used in the income approach is the pre-tax rate of return set by the ORR. The ORR performs a periodic review every five years, which leads to the setting of the appropriate rate for the five-year period. The ORR's method encompasses advice from consultants, comparisons to similar infrastructure assets and discussions with Network Rail. Management believes this cost of capital reflects the assumptions that a market participant would make in arriving at a discount rate.

Should the ORR amend the permitted rate of return in future quinquennial reviews, the regulator would raise or lower the permitted charges to customers so as to achieve the new rate of return. In other words, the cash flows would change but the RAB would not.

The ORR confirmed that a conventionally funded market participant would receive an allowed return equal to the full market cost of capital. This has been reiterated in their final determination for CP6. Management expects that if the rail network asset were to be transferred to a private owner during CP6, ORR would determine the private owner's revenue requirement for CP6 using the pre-tax (CPI) WACC of 4.15 % set out in their final determination for this Control Period. Management expects that the rate of return set by the regulator in subsequent quinquennial reviews will be consistent with the market discount rates for infrastructure assets at the quinquennial review date.

Accordingly, the valuation includes a reassessment of this rate to determine whether it continues to reflect market conditions. This assessment is by reference to movements in observable market data, including the risk-free cost of borrowing, and changes in the weighted average cost of capital of listed utilities with similar gearing ratios. The following table shows the effect of changes in the market discount rate on the carrying value of the rail network and on the depreciation charge. The analysis only considers the effects of movements in the market discount rate until the end of Control Period 6 (2024), and not in perpetuity. The effect of changes in the market discount rate apply equally to increases and to decreases in discount rates.

	Change in cost of capital (basis points)	31 March 2020	31 March 2019
Change in fair value	25	**£843m**	£835m
	50	**£1,682m**	£1,675m
Percentage change in fair value	25	**1.2%**	1.2 %
	50	**2.3%**	2.3 %
Change in annual depreciation charge	25	**£21m**	£21m
	50	**£42m**	£42m

Forecast performance variations

In assessing the value of the rail network, management considers that a knowledgeable willing third party would take into account the perceived fairness and deliverability of the current regulatory determination. Accordingly, management makes an addition (or deduction) to the valuation for its assessment of the likely ORR determination in respect of the financial consequences of anticipated future out (or under) performance against the regulatory determination.

Cost outturns on capital work (renewals and enhancements) have an impact on future cash flows under the regulatory framework, since only efficient overspending in excess of regulated cost targets can be added to the RAB.

At 31 March 2020 the valuation included £475m (2019: £281m) of projected financial underperformance, which is expected to crystallise in the income statement over the next four years. The majority of the brought-forward variance relates to an in-built difference relating to the assumed position regarding train performance in the regulatory determination as at 1 April 2019, and the actual position at that date. The further reduction in discounted future cashflows of £194m in the year has largely been as a result of the impact on property income, particularly retail income in our stations, of the measures taken to safeguard against the public health impact of the global pandemic.

12. Property, plant and equipment – the rail network continued

The reduction relates principally to the impact expected during 2020-21, with property income close to baseline expected from 21-22 onwards; in making this assumption, Network Rail notes the long-term value of managed station presence to our tenants during and after economic recovery, and as a driver for sales as station footfall increases. Measures taken to change franchise contracts by both DfT and Transport Scotland has allowed train operating companies to continue to settle amounts owed to Network Rail as they fall due.

Forecasting the future cash flows produces a broader range of scenarios as a result of uncertainty in economic projections following the global pandemic. Before the pandemic the valuation was centred on a potential range of outcomes at around 3 % of the valuation, increasing to around 6 % by the balance sheet date, as a result of economic uncertainty.

Critical judgements

The valuation includes the following critical judgements:

a) The regulatory framework, and associated cash flows remain sufficiently stable and robust to form the basis of a third party valuation. As noted above, the ORR has made it clear in its final determination for Control Period 6 that the amendments made to the regulatory framework for CP6 reflect the proximity of Network Rail to the public sector and the amendments would not apply to a market participant.
b) The ORR has committed to providing a market cost of capital return to a conventionally funded owner and operator of the network and the fair value calculation has been prepared on that basis. Accordingly, no adjustment has been made to the valuation in respect of the difference between the regulatory rate of return and a market participant cost of capital.
c) Management's assessment of the deliverability of the current regulatory determination is a good indication of how other management groups would perform against the determination.
d) The deliverability of the current 5-year regulatory determination does not have any implication for the deliverability of future determinations (i.e. the ambition of the regulator at the start of each Control Period is to set the regulatory determination at a level which is challenging but achievable).
e) The RAB includes historic expenditure on the company's investment properties. In accordance with IAS 40 Investment Property and IFRS 5 Non-current Assets Held for Sale and Discontinued Operations the fair value of investment property and assets held for sale is separately recognised in Notes 13 and 15 to the accounts. The fair value of the railway network excludes the fair value of RAB-funded investment properties (and assets held for sale) on the grounds that a private owner of the railway network would not expect to derive any future economic benefit from the sale of investment property (i.e. the regulator would make a downwards adjustment to the RAB for the value of any investment properties sold). The valuation performed at 31 March 2020 includes a downwards adjustment of £251m to exclude the fair value of investment property and assets held for sale (31 March 2019: £232m).

At 31 March 2020 the group had entered into contractual commitments in respect of capital expenditure amounting to £1,739m (2019: £2,113m).

We have classified the valuation of the rail network as Level 3 under IFRS 13. The network's fair value is the estimated future cash flows that will be generated in perpetuity, discounted at the regulatory cost of capital, as set by the ORR in its Periodic Review. The cost of capital at which cash flows are discounted is the key unobservable input in the valuation. The full market cost of capital determined by the ORR, on an annual basis, is 3.8 % (2019:3.8 %) for the current control period. This is arrived at through advice from consultants, comparisons to similar infrastructure assets and discussions with Network Rail.

An increase in the market cost of capital would lead to a decrease in the valuation of the rail network and vice versa. However, the impact would be limited to the current control period as the regulator would re-evaluate the allowed return and reset it to the market rate at the next quinquennial review.

Notes to the financial statements continued

13. Investment property

	Group £m
Fair value	
At 31 March 2018	**206**
Additions	-
Disposals	(14)
Transfer (to)/from property, plant and equipment	-
Transfer (to)/from assets held for sale	5
Increase in fair value in the year	35
At 31 March 2019	**232**
Additions	-
Disposals	(8)
Transfer (to)/from property, plant and equipment	-
Transfer (to)/from assets held for sale (Note 15)	-
Increase in fair value in the year	3
At 31 March 2020	**227**

The market values of the group's investment properties at 31 March 2020 have been arrived at on the basis of a valuation carried out at that date in conjunction with Jones Lang LaSalle, external valuers not connected with the group. Network Rail Property undertake a detailed review of the investment property portfolio to allocate the portfolio to beacons which represent particular groups of property sharing the same characteristics. Network Rail Property apply yields provided by Jones Lang LaSalle to these beacon categories. Jones Lang LaSalle will also value specific properties, as instructed by Network Rail Property.

Management are satisfied that Jones Lang LaSalle hold a recognised and relevant professional qualification, and have had recent experience in the location and category of the investment property being valued. The fair value of the group's investment property portfolio is deemed to be the market value.

The valuation, which conforms to International Valuation Standards, was arrived at by splitting the portfolio between one-off individual properties to be valued separately and the remainder of the portfolio to be valued under the Beacon method.

Jones Lang LaSalle provided independent valuations of 11 one-off individual properties (2019: 8), amounting to 46 per cent (2019: 36 per cent) of the total valuation. The balance of the estate was valued under the Beacon method by splitting the portfolio into 18 homogeneous classes (2019: 18) of property and areas, assuming that the current passing rent received from these properties are in line with market rent. Jones Lang LaSalle independently assessed the appropriate yield to be adopted within each of these classes and areas. This enabled the directors to estimate market values by applying the provided yields to the net rental income from these properties, in accordance with a standard UK investment property valuation.

The property rental income earned by the group from assets categorised at the year end as investment property, all of which is leased out under operating leases, amounted to £15.6m (2019: £18m). Direct operating expenses arising on the investment properties in the year amounted to £2.9m (2019: £4.4m).

The group's investment properties are let on a tenant repairing basis. The group's maintenance obligations are limited to common areas and vacant property units.

Property valuations are by their nature subjective, as they are made on the basis of assumptions made by the valuer. They have been classified as Level 3 and the key inputs to the valuations, defined as 'unobservable' by IFRS 13, are analysed in the table below.

		Estimated rental value per sq. ft			Equivalent yield		
	Fair value at 31 March 2020 £m	Minimum £	Maximum £	Weighted average £	Minimum %	Maximum %	Weighted average %
Valuation Technique:							
One-off valuation	**106**	**0.39**	**200**	5.43	4.0	11.3	6.5
Beacon method*	**121**	**n/a**	**n/a**	n/a	5.0	15.0	8.2

* The Beacon methodology splits all the properties within the portfolio into 18 homogenous groups. The properties in each group are valued by applying a yield to the annual rent (passing or void) for the property. Yields applied are on the basis that the property is rack rented i.e. the current passing rent received from these properties are in line with market rent. As such, an estimated rental value per square feet for these properties is not available.

All other factors being equal, a higher yield would lead to a decrease in the valuation of a property and an increase in the current or estimated future rental stream would have the effect of increasing the capital value, and vice versa. However, there are interrelationships between the unobservable inputs which are influenced by market conditions, which would impact the changes in fair value.

14. Investments in subsidiaries and joint ventures

Subsidiaries in the financial statements are included in the table below.

Principal subsidiaries	Country of incorporation	Proportion of all classes of issued share capital owned	Principal activities
Network Rail Infrastructure Limited	Great Britain	100 %	Operation, maintenance and renewal of the national railway infrastructure
Network Rail Insurance Limited	Guernsey	100 %	Insurance
Network Rail Holdco Limited*	Great Britain	100 %	Holding company of Network Rail Infrastructure Limited
Network Rail (High Speed) Limited	Great Britain	100 %	Holds St Pancras concession and High Speed Railway Services Agreement
Network Rail Development Limited	Great Britain	100 %	Holds 49.95 % of each of the property joint ventures Solum Regeneration Limited Partnership and Solum Regeneration Epsom Limited Partnership
Network Rail Pension Trustee Limited	Great Britain	Company limited by guarantee	Administration of defined contribution and CARE defined benefit pension schemes
Network Rail Consulting Limited	Great Britain	100 %	International rail consultancy
Network Rail Certification Body Limited	Great Britain	100 %	Conformity assessment services to the rail industry
Network Rail (VY1) Limited	Great Britain	100 %	Holds land required for works access
Network Rail (VY2) Limited	Great Britain	100 %	Holds land required for works access
Network Rail (Stations) Limited	Great Britain	100 %	Holds a head lease for a retail development
Network Rail (Projects) Limited	Great Britain	100 %	Non trading
Network Rail (Assets) Limited	Great Britain	Company limited by guarantee	Other business support activities
Network Rail Corporate Secretary Limited	Great Britain	100 %	The company provides secretarial services to other companies within the Network Rail group
Network Rail Property Limited	Great Britain	100 %	To assess the integrated performance of NR's property business
Victoria Place Shopping Centre Ltd	Great Britain	100 %	Real estate
Spacia (2002) Ltd	Great Britain	100 %	Non trading company
Railway Property Ltd	Great Britain	100 %	Non trading company
Kew Bridge Manco Limited	Great Britain	Company limited by guarantee	Non trading company
Railway Safety & Standards	Great Britain	Company limited by guarantee	Non trading company
Railway Safety	Great Britain	Company limited by guarantee	Other passenger land transport
Newcastle NE1 Limited	Great Britain	Company limited by guarantee	NE1 is a not for profit Business Improvement District (BID)
Shares held by a trustee			
Network Rail Infrastructure Finance PLC	Great Britain	Intertrust Corporate Services Limited	Issuer of the Debt Issuance Programme
Network Rail MTN Finance Limited	Great Britain	Intertrust Corporate Services Limited 99.998 %, Intertrust Nominees limited 0.002 %	Issuer of NR's Mediun Term Note ('MTN') Programme.

* Directly owned by Network Rail Limited company.

The shares in Network Rail Infrastructure Finance PLC are held by HSBC Trustee (C.I.) Limited, for charitable purposes. The sole purpose of this company is to act as a special purpose funding vehicle. The company is treated as a subsidiary for accounting purposes as proceeds from debt issuances are lent on to Network Rail Infrastructure Limited and are used to finance the activities and to refinance the existing debt of the group.

Notes to the financial statements continued

14. Investments in subsidiaries and joint ventures continued

Joint ventures accounted for by the equity accounting method in the financial statements are included in the table below.

Joint ventures	Country of incorporation	Proportion of all classes of issued share capital owned	Principal activities
Innova Investment Partnership GP Limited	Great Britain	50 %	Hold 0.1 % in Innova Investment Limited Partnership
Innova Investment Limited Partnership	Great Britain	49.95 %	Property development
West Hampstead Square LLP	Great Britain	50 %	Property development
Blockwork LLP	Great Britain	50 %	Property development
The Station Office Network LLP	Great Britain	50 %	Provides flexible office space, meeting rooms and virtual offices
Solum Regeneration Epsom (GP) Limited	Great Britain	50 %	Hold 0.1 % in Solum Regeneration (Epsom) Limited Partnership
Solum Regeneration (Epsom) Limited Partnership	Great Britain	49.95 %	Property development
Solum Regeneration (Haywards) LLP	Great Britain	50 %	Property development
Solum Regeneration (Guildford) LLP	Great Britain	50 %	Property development
Solum Regeneration (Twickenham) LLP	Great Britain	50 %	Property development
Solum Regeneration (Bishops) LLP	Great Britain	50 %	Property development
Solum Regeneration (Surbiton) LLP	Great Britain	50 %	Property development
Solum Regeneration Holding 2 LLP	Great Britain	50 %	Property development
Solum Regeneration (Maidstone) LLP	Great Britain	50 %	Property development
Solum Regeneration (Walthamstow) LLP	Great Britain	50 %	Property development
Solum Regeneration (Redhill) LLP	Great Britain	50 %	Property development
Solum Regeneration (Kingswood) LLP	Great Britain	50 %	Property development
Solum Regeneration Holding 1 LLP	Great Britain	50 %	Property development

The movement in the investment in joint ventures is as follows:

	2020 Group £m	2019 Group £m
At 1 April	44	35
Investment in joint ventures	(1)	9
Share of profit/(loss)	(2)	-
At 31 March	**41**	**44**

15. Assets held for sale

	2020 Group £m	2019 Group £m
At 1 April	10	1,134
Transfer from investment property	-	(5)
Transfer from trade and other payables	-	(7)
Transfers from property, plant and equipment	23	-
Additions	-	22
Disposals	(9)	(1,134)
At 31 March	**24**	**10**

Under IFRS 13, the assets are classified as Level 3.

Notes to the financial statements continued

16. Inventories

	2020 Group £m	2019 Group £m
Raw materials and consumables	**262**	**226**

As at 31 March 2020 a provision of £27m (2019: £26m) was held in respect of inventories.

17. Trade and other receivables

Current assets: trade and other receivables	2020 Group £m	2019 Group £m	2020 Company £m	2019 Company £m
Trade receivables				
- receivable from contracts with other customers	262	201	-	-
- receivable from agreements with government	-	34	-	-
- receivable from property portfolio customers	164	112	-	-
Capital grants receivable	503	270	-	-
Other taxation and social security	135	134	-	-
Collateral receivable	534	727	-	-
Other receivables	32	-	-	-
Prepayments	70	55	-	-
Accrued income				
- receivable from contracts with other customers	124	130	-	-
- receivable from property portfolio customers	53	76	-	-
Total	**1,877**	**1,739**	**-**	**-**

Trade receivables from contracts with customers, agreements with government and from the property portfolio are all based on unconditional rights to consideration, and are not contingent on conditional or dependent on satisfying other performance obligations.

Trade receivables include an allowance for estimated irrecoverable amounts from the supply of services of £31m (2019: £22.5m). This allowance has been made by reference to past default experience. Past default experience is adjusted for forward looking information where relevant. The group provides fully for receivables overdue by over six months. Average debtor days were 50 days (2019: 47 days).

The directors consider that the carrying value of trade and other receivables approximates to their fair value. All balances are non-interest bearing and denominated in sterling.

The group's credit risk is primarily attributable to its trade receivables. Around 96 per cent of the company's income is received from train operating companies and in the form of revenue grants from Government. Franchises are issued to train operating companies by the Department for Transport in England and Wales and Transport Scotland in Scotland. The group believes that amounts receivable from Government and the train operating companies represent a high level of credit quality. This is because in the extraordinary circumstance that a train operating company were to be unable to meet its obligations then provisions in the franchise agreements allow the Department for Transport to take over services at any time. Measures taken to change franchise contracts by both DfT and Transport Scotland during the global pandemic have allowed train operating companies to continue to settle amounts owed to Network Rail as they fall due. Before accepting any other new customer, the group uses an external credit scoring system to assess the potential customer's credit quality.

Included in the group's trade receivable balance are amounts totalling £90m (2019: £40m) which are past due at the reporting date for which the group has not provided as there has not been a significant change in the credit quality and the amounts are still considered recoverable. The group does not hold collateral over these balances. The average age of these receivables is 32 days (2019: 21 days).

The following table shows the age of financial assets for the group which are past due and for which no specific provision has been raised:

Current assets: trade and other receivables	2020 Group £m	2019 Group £m	2020 Company £m	2019 Company £m
Past due by 1 – 28 days	39	32	-	-
Past due by 29 – 56 days	18	2	-	-
Past due by 57 – 84 days	12	3	-	-
Past due by 85 – 180 days	27	12	-	-
	96	**49**	**-**	**-**

Trade receivables of £21m (2019: £15m) are overdue by six months or more, and have been fully provided for.

Notes to the financial statements continued

18. Trade and other payables

Current liabilities: trade and other payables	2020 Group £m	2019 Group £m	2020 Company £m	2019 Company £m
Trade payables	534	782	-	-
Collateral held from banking counterparties	120	38	-	-
Payments received on account	25	15	-	-
Other payables	495	359	-	-
Other interest accruals	282	287	-	-
Other accruals	910	1,434		
Deferred income				
- from contracts with other customers	1,252	414	-	-
- from property portfolio customers	19	77	-	-
Total	**3,637**	**3,406**	**-**	**-**

IFRS 15 uses the term 'contract liability' to describe what might more commonly be known as 'deferred income', however the Standard does not prohibit an entity from using alternative descriptions in the statement of financial position. The Group has not adopted the terminology used in IFRS 15 to describe such balances.

£55m of the property deferred income balance at the beginning of the year was recognised as revenue in the current year.

The average credit period taken for trade purchases is 36 days (2019: 29 days).

Before accepting new suppliers, and upon letting significant contracts, the group evaluates suppliers' creditworthiness using external credit scoring systems and other relevant data.

The directors consider that the carrying value of trade and other payables approximates to their fair value. All balances are ordinarily non-interest bearing and denominated in sterling.

Non-current liabilities: other payables	2020 Group £m	2019 Group £m	2020 Company £m	2019 Company £m
Capital grants deferred income	471	150	-	-
Other payables	77	176	-	-
Total	**548**	**326**	**-**	**-**

As part of the acquisition of Railtrack PLC, Network Rail received a grant of £300m from the Strategic Rail Authority to fund the purchase. In line with Network Rail's accounting policy this revenue is deferred and amortised over the average remaining life of the railway network (as this represents the substantial part of the assets purchased), currently 40 years, on a straight-line basis.

19. Borrowings

The borrowings balance is split as follows:

	2020 Group £m	2019 Group £m	2020 Company £m	2019 Company £m
Net borrowings by instrument:				
Cash and cash equivalents	430	450	-	-
Collateral placed with counterparties	534	727	-	-
Collateral received from counterparties	(120)	(38)	-	-
Bank loans	(514)	(500)	-	-
Lease liabilities	(411)	–	-	-
Bonds issued under the Debt Issuance Programme (less unamortised premium, discount and fees)	(24,686)	(24,196)	-	-
Borrowings issued by the Department for Transport*	(29,834)	(30,580)	-	-
	(54,601)	**(54,137)**	**-**	**-**
Movement in net borrowings:				
At the beginning of the year	(54,137)	(51,297)	-	-
Decrease in cash and cash equivalents	(20)	(523)	-	-
Proceeds from borrowings	(11,559)	(6,003)	-	-
Repayments of borrowings**	12,029	4,597	-	-
Capital accretion	(513)	(496)	-	-
Exchange differences	(19)	(8)	-	-
Movement in collateral placed with counterparties	(193)	(23)	-	-
Movement in collateral received from counterparties	(82)	49	-	-
Movement in lease liabilities (see Note 24)	(411)	-	-	-
Decrease/(increase) in DFT collateral facility**	275	(685)	-	-
Fair value and other movements	29	252	-	-
At the end of the year	**(54,601)**	**(54,137)**	**-**	**-**

Net borrowings are reconciled to the balance sheet as set out below:				
Cash and cash equivalents	430	450	-	-
Collateral placed with counterparties (included in trade and other receivables)	534	727	-	-
Collateral received from counterparties (included in trade and other payables)	(120)	(38)	-	-
Borrowings included in current liabilities	(10,781)	(11,557)	-	-
Borrowings included in non-current liabilities	(44,664)	(43,719)	-	-
	(54,601)	**(54,137)**	**-**	**-**

* As at 31 March 2020, a collateral facility of £410m (2019: £685m) was included within this balance.

** Included in repayment of borrowings in cash flow statement.

Notes to the financial statements continued

19. Borrowings continued

	2020 Group £m	2019 Group £m	2020 Company £m	2019 Company £m
1.085 % sterling index linked bond due 2052	141	137	-	-
0 % sterling index linked bond due 2052	154	149	-	-
1.003 % sterling index linked bond due 2051	27	26	-	-
0.53 % sterling index linked bond due 2051	136	133	-	-
0.517 % sterling index linked bond due 2051	136	133	-	-
0 % sterling index linked bond due 2051	154	149	-	-
0.678 % sterling index linked bond due 2048	134	131	-	-
1.125 % sterling index linked bond due 2047	5,819	5,685	-	-
0 % sterling index linked bond due 2047	99	95	-	-
1.1335 % sterling index linked bond due 2045	55	53	-	-
1.5646 % sterling index linked bond due 2044	308	299	-	-
1.1565 % sterling index linked bond due 2043	61	60	-	-
1.1795 % sterling index linked bond due 2041	75	73	-	-
1.2219 % sterling index linked bond due 2040	302	294	-	-
1.2025 % sterling index linked bond due 2039	82	80	-	-
4.6535 % sterling bond due 2038	100	100	-	-
1.375 % sterling index linked bond due 2037	5,717	5,578	-	-
4.75 % sterling bond due 2035	1,234	1,232	-	-
1.6492 % sterling index linked bond due 2035	459	447	-	-
4.375 % sterling bond due 2030	872	872	-	-
1.75 % sterling index linked bond due 2027	5,548	5,435	-	-
4.615 % Norwegian krone bond due 2026*	47	53	-	-
4.57 % Norwegian krone bond due 2026*	13	15	-	-
1.9618 % sterling index linked bond due 2025	389	378	-	-
4.75 % sterling bond due 2024	743	742	-	-
3 % sterling bond due 2023	399	398	-	-
2.76 % Swiss franc bond due 2021	251	231	-	-
2.315 % Japanese yen bond due 2021*	77	73	-	-
2.28 % Japanese yen bond due 2021*	77	73	-	-
2.15 % Japanese yen bond due 2021*	77	73	-	-
4.625 % sterling bond due 2020	1,000	1,000	-	-
	24,686	**24,197**	**-**	**-**

* Bonds treated as fair value through profit and loss.
All other bonds are shown net of unamortised discount and fees.

19. Borrowings continued

Bank loans are analysed as follows:

	2020 Group £m	2019 Group £m	2020 Company £m	2019 Company £m
Index-linked European Investment Bank due 2036 (£251m) and 2037 (£249m)	514	500	-	-
	514	**500**	**-**	**-**

At 31 March 2020 and 2019 the group had the following undrawn committed borrowing facilities at nominal value:

	2020 Drawn £m	2020 Undrawn £m	2020 Total £m	2019 Drawn £m	2019 Undrawn £m	2019 Total £m
Department for Transport loan facility	29,439	2,420	31,859	29,909	-	29,909
Department for Transport collateral facility	410	390	800	685	315	1,000
	29,849	**2,810**	**32,659**	**30,594**	**315**	**30,909**

Undrawn committed facilities expire as follows:

	2020 Group £m	2019 Group £m
Within one year	-	-
Within two to five years	2,420	-
After five years	-	-
	2,420	**-**

On 4 July 2014, the Secretary of State for Transport provided the group with a loan facility of £30,875m expiring on 31 March 2019. Following the asset divestment programme, the loan facility was reduced to £29,909m which had been fully drawn as at 31 March 2019. On 28 March 2019, a new facility was signed which became available for drawing on 1 April 2019 (the '2019 facility'). The 2019 facility has a drawdown limit of £32,329m. Following the CVL disposal, this facility was reduced to £31,859m. In addition, the Secretary of State for Transport has provided unlimited financial indemnity in respect of borrowings under the Debt Issuance Programme which expires in 2052.

Notes to the financial statements continued

20. Derivative financial instruments

	2020 Group		2019 Group	
	Fair value £m	Notional amounts £m	Fair value £m	Notional amounts £m
Derivative financial instrument assets				
Cash flow hedges				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	138	128	126	128
Fair value hedges				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	-	-	-	-
Non-hedge accounted derivatives				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	98	198	95	199
Interest rate swaps	245	10,670	129	10,711
Forward foreign exchange contracts	3	1	-	3
	484	**10,997**	**350**	**11,041**
Included in non-current assets	474	9,396	340	9,552
Included in current assets	10	1,601	10	1,489
	484	**10,997**	**350**	**11,041**
Derivative financial instrument liabilities				
Cash flow hedges				
Interest rate swaps	(11)	130	(15)	130
Forward starting interest rate swaps			-	-
Non-hedge accounted derivatives				
Interest rate swaps to hedge debt issued under the Debt Issuance Programme	(883)	12,380	(1,016)	19,852
Forward foreign exchange contracts	(1)	22	(2)	48
	(895)	**12,532**	**(1,033)**	**20,030**
Included in current liabilities	(48)	3,189	(52)	4,975
Included in non-current liabilities	(847)	9,344	(981)	15,055
	(895)	**12,533**	**(1,033)**	**20,030**

See Note 25: Funding and financial risk management for further details on the risk management strategy. Notional amounts above reflect the contractual value relating to the principal instrument (e.g. bond) to which the derivative relates.

21. Provisions

	Restructuring £m	Legal £m	Commercial and other claims £m	Total £m
At 1 April 2019	**1**	**22**	**41**	**64**
Charge for the year	5	2	28	35
Utilised in the year	-	(1)	(7)	(8)
Release for the year	(1)	(2)	(8)	(11)
At 31 March 2020	**5**	**21**	**54**	**80**

The group has also provided against a number of claims arising from interpretations of legal contracts or past events for which settlement is expected to be achieved in the next year, but could be deferred to future years depending on the legal interpretation of rights and responsibilities under the contracts as well as commercial negotiation.

Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date. The nature of these claims means that there is some uncertainty with regard to the value that they will be settled at. If the outcomes of the claims are different to the assumptions underpinning the directors' best estimates then a further liability may arise.

Contingent liability

The group's lawyers have advised that detailed disclosure regarding the nature and amount of contingent liabilities, beyond that disclosed here, could be expected to prejudice the position of the group. The general nature of contingent liabilities are development indemnities and warranties.

22. Deferred tax

The following are the deferred tax liabilities and assets recognised by the group and movement thereon during the current and prior year.

Group	Accelerated tax depreciation £m	Unrealised Gain on Investment Property £m	Revaluation of railway network £m	Short-term timing differences including retirement benefit obligations £m	Derivatives £m	Tax losses £m	Total £m
At 31 March 2018	**2,421**	-	**162**	**(53)**	**(22)**	-	**2,508**
Charge/(credit) to income	165	(98)	-	(48)	(6)	(1)	12
Charge/(credit) to other comprehensive income	-	-	447	(4)	29	-	472
Transfer between reserves	-	-	(13)	13	-	-	-
Reclassification	(58)	58	-	-	-	-	-
Utilisation of losses previously derecognised	-	-	-	-	-	1	1
Derecognition of deferred tax asset (income)	-	40	-	-	-	-	40
Derecognition of deferred tax asset (equity)	-	-	-	-	(29)	-	(29)
At 31 March 2019	**2,528**	**-**	**596**	**(92)**	**(28)**	**-**	**3,004**
Charge/(credit) to income	157	3	-	(33)	6	1	134
Charge/(credit) to other comprehensive income	-	-	(50)	141	46	-	137
Impact of rate change on deferred tax asset (income)	299	-	-	(31)	(3)	-	265
Impact of rate change on deferred tax asset (equity)	-	-	70	20	(1)	-	89
Transfer between reserves	-	-	(12)	12	-	-	-
Utilisation of losses previously derecognised	-	-	-	-	-	(1)	(1)
Derecognition of deferred tax asset (income)	-	(3)	-	-	-	-	(3)
Derecognition of deferred tax asset (equity)	-	-	-	-	(45)	-	(45)
At 31 March 2020	**2,984**	**-**	**604**	**17**	**(25)**	**-**	**3,580**

Certain deferred tax assets and liabilities have been offset. The following is the analysis of the gross deferred tax balances:

	2020 £m	2019 £m
Deferred tax liabilities	3,605	3,124
Deferred tax assets	(25)	(120)
	3,580	**3,004**

Under IAS 12 deferred tax assets can only be recognised where it is probable that taxable profits will be available against which the deferred tax asset can be utilised. Additionally, whilst taxable income does not exceed allowable deductions in the year, Network Rail claims only the capital allowances sufficient to make the necessary claims for group relief and available tax credits.

23. Notes to the statement of cash flows

	2020 Group £m	2019 Group £m	2020 Group £m	2019 Company £m
Profit/(Loss) before tax	375	(173)	-	-
Adjustments for:				
Property revaluation movements and profits on disposal	(3)	(363)	-	-
Fair value gain on derivatives and debt	(213)	(220)	-	-
Net interest expense	2,163	2,189	-	-
Depreciation of the rail network and leases under IFRS 16	2,022	1,810	-	-
Amortisation of grants	(169)	(144)	-	-
Amortisation of intangible assets	1	1	-	-
Movement in retirement benefit obligations	188	169	-	-
Increase/(Decrease) in provisions	16	(17)	-	-
Operating cash flows before movements in working capital	**4,380**	**3,252**	**-**	**-**
Increase in inventories	(36)	(11)	-	-
Increase in receivables	(98)	(167)	-	-
Increase in payables	677	548	-	-
Cash generated from operations	**4,923**	**3,622**	**-**	**-**

Cash and cash equivalents

Cash and cash equivalents (which are represented as a single class of assets on the face of the balance sheet) comprise cash at bank, collateral and commercial paper, all of which are on call with the exception of short-term deposits. There were £524m (excluding offsetting clearing accounts) of short term deposits with the government banking scheme (“GBS”) held as at 31 March 2020 (2019: £502m).

Notes to the financial statements continued

24. Leases

Group as a lessee

Property lease payments largely represent rentals payable by the group for certain of its office properties. In addition rentals are paid for land adjacent to the railway required for maintenance and renewal activities. Non-property leases include the group's vehicles, on track machines and wagons that are leased.

The movement in the period for the lease liability is reconciled as follows:

	Property leases £m	Non property leases £m	Total £m
Balance recognised on transition at 1 April 2019	248	162	410
New leases entered into in the period	39	64	103
Leases renewed in the period	-	-	-
Interest charged in the period	9	6	15
Payments in the period	(66)	(51)	(117)
Lease liability at 31 March 2020	**230**	**181**	**411**

The lease liabilities are split between the current and non-current liabilities as shown below:	2020 £m	2019 £m
Current lease liabilities	92	-
Non-current lease liabilities	319	-
Total lease liabilities	**411**	**-**

The movement in the period for the ROU assets is reconciled as follows:

	Property leases £m	Non property leases £m	Total £m
Balance recognised on transition at 1 April 2019	248	162	410
New leases entered into in the period	39	64	103
Leases renewed in the period	-	-	-
Depreciation charged in the period	(41)	(44)	(85)
Right of use asset at 31 March 2020	**246**	**182**	**428**

Expenses relating to short-term lease (included in net operating costs) were £2m. The total cash outflow for leases during the year was £119m.

The following table details the group's remaining contractual maturity for its financial liabilities. See note 25 for details of how liquidity risk is managed across the group.

Group	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	Total £m
Lease liabilities	97	87	182	117	**483**

Group as a lessor

Minimum lease payments receivable on leases where the group is lessor are as follows:

Group	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	Total £m
Minimum lease payments receivable	433	385	761	2,184	**3,763**

25. Funding and financial risk management

Introduction

The group is almost entirely debt financed. Debt has been issued through the special purpose financing company Network Rail Infrastructure Finance PLC, which is not a member of the Network Rail Limited group, but is treated as a subsidiary for accounting purposes. The majority of the group's existing debt has been issued by Network Rail Infrastructure Finance PLC under the Debt Issuance Programme which is rated AA by Standard and Poor's, Aa2 (outlook stable) by Moody's and AA (outlook negative) by Fitch. The Debt Issuance Programme is supported by a financial indemnity from the Secretary of State for Transport which expires in 2052.

Debt has been issued in a number of currencies and a range of maturities which gives rise to interest rate, foreign currency and inflation risk. Financial risk management aims to mitigate these risks.

Reclassification of Network Rail

In December 2013, the Office for National Statistics announced the reclassification of Network Rail as a Central Government Body in the UK National Accounts and Public Sector Finances with effect from 1 September 2014. This is a statistical change driven by guidance in the European System of National Accounts 2010 (ESA10).

As part of Network Rail's formal reclassification to the public sector, an arrangement was agreed whereby funding would be provided by the DfT in the form of a loan made directly to Network Rail Infrastructure Limited, to fund the continuing programme of long-term investment in the national rail network. Network Rail Infrastructure Finance PLC does not anticipate issuing further bonds in the foreseeable future and its debt service obligations would be met through repayments of the intercompany loan by Network Rail Infrastructure Limited.

All of the outstanding bonds under the Debt Issuance Programme, including nominal and index-linked benchmarks and private placements in all currencies, will continue to benefit from the direct and explicit guarantee from the UK Government under the Financial Indemnity Mechanism. In the unlikely event that the DfT withdraws or breaches its obligations on the loan facility to Network Rail the group may issue further bonds or commercial paper to meet funding requirements.

Notes to the financial statements continued

25. Funding and financial risk management continued

Summary table of financial assets and liabilities

The following table presents the carrying amounts and the fair values of the group's financial assets and liabilities at 31 March 2020 and 31 March 2019.

The fair values of the financial assets and liabilities are recorded at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The following methods and assumptions were used to estimate the fair values where balances were not already held at fair value (see Accounting policies in Note 2):

- Bank loans – based on market data at the balance sheet date and the net present value of discounted cash flows
- Bonds issued under the Debt Issuance Programme – based on market data at the balance sheet date. Where market data is not available valuations have been obtained from dealing banks.

For cash and cash equivalents, finance lease receivables, trade and other payables and trade and other receivables, fair value equates to carrying value.

Group	2020 Carrying value £m	2020 Fair value £m	2019 Carrying value £m	2019 Fair value £m
Financial assets				
Cash and cash equivalents	430	430	450	450
Other non-derivative financial assets				
Trade and other receivables (less prepayments and accrued income and other taxation and social security)	961	961	617	617
Collateral receivable	534	534	727	727
Derivatives				
Derivatives designated as cash flow hedging instruments	138	138	126	126
Other derivatives as fair value through profit and loss	346	346	224	224
Total financial assets	**2,409**	**2,409**	**2,144**	**2,144**
Financial liabilities				
Financial liabilities held at amortised cost				
Bank loans	(514)	(900)	(500)	(853)
Bonds issued under the Debt Issuance Programme	(24,395)	(30,328)	(23,909)	(29,518)
Borrowings issued by Department for Transport	(29,834)	(30,374)	(30,580)	(30,523)
Collateral payable	(120)	(120)	(38)	(38)
Trade and other payables at amortised cost (less deferred income)	(2,443)	(2,443)	(3,091)	(3,091)
Financial liabilities designated as fair value through profit and loss				
Bonds issued under the Debt Issuance Programme	(291)	(291)	(287)	(287)
Derivatives				
Derivatives designated as cash flow hedging instruments	(11)	(11)	(15)	(15)
Other derivatives as fair value through profit and loss	(884)	(884)	(1,018)	(1,018)
Total financial liabilities	**(58,492)**	**(65,351)**	**(59,438)**	**(65,343)**

As shown in the above table, the bonds issued under the Debt Issuance Programme have fair values significantly in excess of their carrying values. These differences are not reflected in the Balance Sheet since the majority of these instruments (See Note 19) were not designated at FVPL on initial recognition and hence are accounted for at amortised cost under IFRS 9. The size of the difference is driven by the overall decrease in market debt yield rates since the inception of these instruments; debt terms in a higher yield environment resulting in a settlement at par would now attract a premium, assuming no other changes to the instrument or wider environment.

25. Funding and financial risk management continued

Derivatives

The group (including the group's special purpose financing company, Network Rail Infrastructure Finance PLC) uses derivative financial instruments to reduce exposure to foreign exchange risk and interest rate movements. The group does not use derivative financial instruments for speculative purposes. Certain derivatives are designated as hedges, and those derivatives that are not hedge accounted are fair valued immediately through the income statement. The group has a comprehensive risk management process.

The board, through a treasury sub-committee (the treasury committee), has approved and monitors the risk management processes, including documented treasury policies, counterparty limits, controlling and reporting structures.

The use of derivative instruments can give rise to credit and market risk. Market risk is the possibility that future changes in foreign exchange rates and interest rates may make a derivative more or less valuable. Since the group uses derivatives for risk management, market risk relating to derivative instruments will principally be offset by changes in the valuation of the underlying assets, liabilities or transactions being hedged.

Credit risk

Network Rail manages its funds with banks that have high credit ratings; assigned by international credit-rating agencies. The treasury committee authorises the policy for setting counterparty limits based on credit ratings. The group spreads its exposure over a number of counterparties and has strict policies on how much exposure can be assigned to each of the counterparties. Surplus liquidity is invested in the Government Banking Scheme which has low credit risk.

For debt designated as fair value through profit and loss (FVTPL) there has been no change in carrying value as a result of changes in the group's credit risk. The loss in the income statement arising from the remeasurement of FVTPL debt items of £4m (2019: £3m) are all attributable to changes in market risk.

The credit risk with regard to all classes of derivative financial instruments entered into before 1 January 2013 is limited because Network Rail has arrangements in place which limit each bank to a threshold (based on credit ratings), which if breached requires the bank to post collateral in cash or eligible securities. The members of the banking group are required to post collateral on positive mark to market swaps above the threshold. In December 2012 the group entered into new collateral agreements in respect of derivative trades entered into after 1 January 2013. Under the terms of the new agreements Network Rail posts collateral on adverse net derivative positions with its counterparties. The new agreements do not contain a provision for thresholds; as such Network Rail or its counterparties are required to post collateral for the full fair value of net out of the money positions. At 31 March 2020 the fair value of collateral held was £120m (2019: £38m). The group is the beneficial owner of this collateral. The group is free to invest or otherwise utilise the collateral at its discretion, subject to acting within the authority sanctioned by the treasury committee. The balance of collateral posted by the group at 31 March 2020 was £534m (2019: £727m).

The group does not have any significant credit risk exposure to any single counterparty and has considered the creditworthiness of debtors. For further detail on the credit-worthiness of customers and suppliers, see Notes 17 (Trade and other receivables) and 18 (Trade and other payables).

The group considers its maximum exposure to credit risk to be the sum of its financial assets, as set out in Note 17.

Foreign exchange risk

Network Rail is exposed to currency risks from its investing, financing and operating activities. Foreign exchange risk for all currencies is managed by the use of forward exchange contracts and currency swaps to limit the effects of movements in exchange rates on foreign currency denominated liabilities.

The group considers a ten percentage point increase in the value of any currency against sterling to be a reasonably possible change and this would not have a material impact on the group's net profit before tax or equity.

Interest rate and inflation risk

The group is exposed to changes in interest rates as funds are borrowed at both fixed and floating interest rates. The hedging strategy approved by the treasury committee defines the appropriate mix between fixed and floating borrowings. Cross-currency and interest rate swap contracts are used to manage the fixed/floating ratio.

Debt with a carrying value of £23,320m (2019: £30,592m) is arranged at or swapped into fixed interest rates and exposes the group to fair value interest rate risk. Other borrowings were arranged at or swapped into floating rates, thus exposing the group to cash flow interest rate risk. They have arranged or swapped other borrowings into floating rates (£198m), thus exposing the group to cash flow interest rate risk.

The group has certain debt issuances which are index-linked and so are exposed to movements in inflation rates. The group does not enter into any derivative arrangements to hedge its exposure to inflation in relation to its index-linked debt, but rather to mitigate the effects of inflation on the group's retail price index-linked revenue streams.

Notes to the financial statements continued

25. Funding and financial risk management continued

Sensitivity analysis

This sensitivity analysis has been determined based on the exposure to interest rates and inflation for both derivative and non-derivative financial instruments at the balance sheet date. A one per cent increase or decrease represents management's assessment of the reasonably possible changes in average interest rates and inflation.

	Group 31 March 2020		Group 31 March 2019	
	Impact on the income statement £m	Impact on equity £m	Impact on the income statement £m	Impact on equity £m
1 % increase in the interest rate	344	3	504	-
1 % increase in the GBP RPI on index linked bonds	(185)	-	(182)	-

A one per cent decrease in the above rates would have an equal and opposite effect.

Interest rate sensitivities have been calculated by comparing the average rates of the derivative financial instruments to the market rate for similar instruments.

The impact of a change in GBP RPI has been calculated by applying a change of one per cent to the RPI at the balance sheet date to the carrying value of the index linked bonds.

Liquidity risk management

The ultimate responsibility for liquidity risk management rests with the board of directors. The policy manual ratified by the treasury committee includes an appropriate liquidity risk management framework covering the group's short, medium and long-term funding and liquidity management requirements. The Treasury funding is subject to regular internal audits. Treasury provides sufficient liquidity to meet the group's needs, while reducing financial risks and prudently maximising interest receivable and minimising credit risk on surplus cash.

The group manages liquidity risk by maintaining sufficient cash and facilities to cover at least one year's working capital requirement by continuously monitoring forecast and actual cash flows. Included in Note 19 is a description of additional undrawn facilities that the group has at its disposal to further reduce liquidity risk.

The following table details the group's remaining contractual maturity for its financial liabilities. The table has been drawn up on the undiscounted cash flows of financial liabilities based on the earliest date on which the group can be required to pay and, therefore, differs from both the carrying value and the fair value. The table includes both interest and principal cash flows.

Group	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	Total £m
31 March 2020					
Non-derivative financial liabilities					
Bank loans and overdrafts	-	-	(1)	(522)	(523)
Bonds issued under the Debt Issuance Programme					
– Sterling denominated bonds	(1,196)	(150)	(1,552)	(3,171)	(6,069)
– Sterling denominated index-linked bonds	(276)	(284)	(900)	(34,900)	(36,360)
– Foreign currency denominated bonds	(14)	(453)	(8)	(62)	(537)
Loan from the Department for Transport	(10,410)	(7,988)	(11,383)	(1,239)	(31,020)
Trade and other payables	(1,431)	(77)	-	-	(1,508)
Lease liabilities	-	-	-	-	-
Derivative financial liabilities					
Net settled derivative contracts	(189)	(113)	(149)	(34)	(485)
Gross settled derivative contracts – receipts	14	453	8	62	537
Gross settled derivative contracts – payments	(3)	(276)	(3)	(58)	(340)
	(13,505)	**(8,888)**	**(13,988)**	**(39,924)**	**(76,305)**

25. Funding and financial risk management continued

Group	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	Total £m
31 March 2019					
Non-derivative financial liabilities					
Bank loans and overdrafts	(6)	(6)	(18)	(582)	(612)
Bonds issued under the Debt Issuance Programme					
– Sterling denominated bonds	(196)	(1,196)	(1,600)	(3,273)	(6,265)
– Sterling denominated index-linked bonds	(268)	(276)	(876)	(34,371)	(35,791)
– Foreign currency denominated bonds	(14)	(14)	(459)	(65)	(552)
Loan from the Department for Transport	(9,592)	(8,163)	(10,741)	(3,218)	(31,714)
Trade and other payables	(1,466)	(175)	-	-	(1,641)
Derivative financial liabilities					
Net settled derivative contracts	(231)	(137)	(247)	(44)	(659)
Gross settled derivative contracts – receipts	14	14	459	65	552
Gross settled derivative contracts – payments	(3)	(6)	(278)	(60)	(347)
	(11,762)	**(9,959)**	**(13,760)**	**(41,548)**	**(77,029)**

Offsetting financial assets and liabilities

Financial assets

The following financial assets are subject to offsetting, enforceable master netting arrangements and similar agreements. The balances have not been presented on a net basis in the financial statements.

Group	Gross amounts of recognised financial assets £m	Gross amounts of recognised financial liabilities set off in the balance sheet £m	Net amount of financial assets presented in the balance sheet £m	Related amounts not set off in the balance sheet: Financial instruments £m	Related amounts not set off in the balance sheet: Cash collateral received £m	Net amount £m
31 March 2020						
Derivative financial assets	484	-	484	(369)	439	**554**
31 March 2019						
Derivative financial assets	350	-	350	(307)	413	**456**

Financial liabilities

The following financial liabilities are subject to offsetting, enforceable master netting arrangements and similar agreements. The balances have not been presented on a net basis in the financial statements.

Group	Gross amounts of recognised financial liabilities £m	Gross amounts of recognised financial assets set off in the balance sheet £m	Net amount of financial liabilities presented in the balance sheet £m	Related amounts not set off in the balance sheet: Financial instruments £m	Related amounts not set off in the balance sheet: Cash collateral paid £m	Net amount £m
31 March 2020						
Derivative financial liabilities	(895)	-	(895)	369	(24)	**(550)**
31 March 2019						
Derivative financial liabilities	(1,033)	-	(1,033)	307	276	**(450)**

Cash flow hedges

Contractual payments on derivatives designated as cash flow hedges impact the income statement and will all have matured by 2027.

Borrowings

Details of the group's undrawn committed facilities and types of debt instrument used can be found in Note 19.

Notes to the financial statements continued

25. Funding and financial risk management continued

Fair value measurements recognised in the balance sheets

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	2020			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivative financial assets	-	484	-	484
Assets	**-**	**484**	**-**	**484**
Derivative financial liabilities	-	(895)	-	(895)
Financial liabilities designated at fair value through profit and loss	-	(291)	-	(291)
Liabilities	**-**	**(1,186)**	**-**	**(1,186)**
Total	**-**	**(702)**	**-**	**(702)**

	2019			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivative financial assets	-	350	-	350
Assets	**-**	**350**	**-**	**350**
Derivative financial liabilities	-	(1,033)	-	(1,033)
Financial liabilities designated at fair value through profit and loss	-	(287)	-	(287)
Liabilities	**-**	**(1,320)**	**-**	**(1,320)**
Total	**-**	**(970)**	**-**	**(970)**

The fair value of level 2 derivatives is estimated by discounting the future contractual cash flows using appropriate yield curves based on quoted market rates as at the current financial year end.

A review of the categorisation of the assets and liabilities into the three levels is made at each reporting date. There were no transfers between Level 1 and Level 2 fair value measurements and no transfers into or out of Level 3 fair value measurements in the current or prior years.

26. Retirement benefit schemes

Defined contribution schemes

On 1 April 2004 the company introduced a defined contribution pension scheme, the Network Rail Defined Contribution Pension Scheme (NRDCPS). These schemes are offered to all new employees of Network Rail, except those who have the legal right to join the Railway Pension Scheme (RPS). Any employee who wishes to transfer from the Network Rail Section of the RPS to the NRDCPS is entitled to do so.

At 31 March 2020, the NRDCPS had 14,185 members (2019: 13,135) and the average employer contribution rate in the year was 4.1 per cent (2019: 4.2 per cent).

Defined benefit schemes

The principal pension scheme in which the company participates is the Railway Pension Scheme (RPS), which was established by statutory instrument, commenced on 1 October 1994 and is a funded defined benefit arrangement. The assets and liabilities under the predecessor scheme, the British Rail Pension Scheme (BRPS), were transferred to the RPS on that date. The RPS is an industry-wide scheme for all eligible employees within the railway industry. There are different sections within it for different employers. The assets and liabilities of each section are identified separately from those of the other sections. The company has its own section, the Network Rail Shared Cost Section (the Network Rail Section). This scheme, the assets of which are held separately from the company, is contributory and provides pensions related to pay at retirement.

The assets transferred to the RPS from the BRPS on 1 October 1994 were apportioned among the various sections of the RPS in accordance with the methods and assumptions specified in The Railways Pensions (Transfer and Miscellaneous Provisions) Order 1994 (the 'Transfer Order') which effected the transfer. The amount credited to the Network Rail Section included a share of the surplus at that time.

Since 1 April 2004, new members can only join the Network Rail Section of the RPS after completing five years of service. Benefits for existing members and employees joining up to and including 31 March 2004 were not affected by the revised eligibility rules of the Network Rail Section. In addition, the company announced its decision to cap its contribution to British Railways Additional Superannuation Scheme (BRASS) matching at current levels for existing employees and to dispense with matching for new employees. The company will continue to match regular contributions but will not increase them in cash terms in the future.

On 1 November 2008 Network Rail launched a third pension scheme – the Career Average Revalued Earnings (CARE) scheme, which is available to all employees.

Qualified actuaries Willis Towers Watson have valued the schemes on an IAS 19 (revised) basis at 31 March 2020 and 31 March 2019.

The contributions required to fund the RPS and the CARE scheme are reassessed every three years, following completion of actuarial valuations (by the Scheme Actuaries). The last full actuarial valuation of both schemes was undertaken by the scheme actuary, Willis Towers Watson, as at 31st December 2016. The triennial valuation is currently ongoing. Under the terms of the Pensions Act 2004, the Trustee and each employer must agree the methods and assumptions used to calculate the 'Technical Provisions', i.e. assets required to meet the Section's liabilities. The assumptions agreed are typically weaker than those used for IAS 19 purposes in current market conditions, so the minimum funding requirement in itself requires no further adjustment to the IAS 19 obligations below. However, the regulatory regime may, depending on legal advice received at the appropriate time, mean that a future employer's accounting surplus would need to be restricted.

The RPS and CARE schemes are both shared cost in nature, so the cost of benefits being earned and the cost of funding any shortfall in the schemes are normally split in the proportion 60:40 between the company and the members. In practice the contributions are adjusted at each triennial valuation to reflect the funding position of the schemes at that time.

The estimated amounts of contributions expected to be paid by the company and members to the schemes during the year ended 31 March 2021 are £122m and £77m respectively. If a surplus or deficit arises, the provisions in the rules mean that the company and members benefit from or pay for this respectively in the proportion 60:40.

Notes to the financial statements continued

26. Retirement benefit schemes continued

	2020 %	2019 %
Key assumptions used:		
Discount rate	2.2	2.3
Expected rate of price inflation and CARE benefit increases (RPI measure)	2.5	3.2
Future earnings increases*		
- after changes to benefits from 1 April 2016	2.5	3.2
Pension increases (CPI measure)	1.8	2.2

* Excluding promotional salary scale. Promotional salary scale increases apply only in respect of service after the date of promotion.

	2020		2019	
	Males	Females	Males	Females
Average life expectancy for mortality tables used to determine defined benefit obligations:				
– Member aged 65	21.1	22.7	22.2	23.8
– Member aged 45	22.8	24.6	23.9	25.7

For Network Rail Section of the RPS the discounted mean term of the defined benefit obligation is 22 years, for the CARE scheme it is 33 years.

Amounts recognised in income in respect of the company's pension arrangement are as follows:

	2020 £m	2019 £m
Current service cost – defined contribution (see note 6)	23	20
Current service cost – defined benefit (see note 6)	283	257
Past service credit - defined benefit (see Note 6)	-	7
Interest cost	58	55
	364	**339**

The current service cost has been included in employee costs, the net interest scheme deficit has been included in finance costs.

Amounts recognised in the statement of comprehensive income in respect of the company's pension arrangement are as follows:

	2020 £m	2019 £m
Gain on defined benefit obligation due to experience	(33)	(46)
(Gain)/Loss on defined benefit obligation due to assumption changes	(752)	285
Return on plan assets less/(greater) than discount rate	43	(208)
Actuarial (gain)/ loss recognised in the statement of comprehensive income	**(742)**	**31**

The cumulative amount of actuarial losses recognised in other comprehensive income was £777m (2019: £1,519m). In the year the discount rate went down by 0.1 % and the RPI assumption by 0.7 %. Several factors contributed to this, including COVID 19, Brexit uncertainty, global trade wars, and recession fears. Mortality assumptions were adjusted in line with those in the triennial funding valuation reducing the defined benefit obligation. These factors combined have had a significant impact on the defined benefit obligation leading to the £752m gain noted above arising from assumption changes. The other movements reduce that gain to £742m which is recorded in the statement of comprehensive income.

The amount included in the balance sheet arising from the company's obligations in respect of its defined benefit schemes is as follows:

	2020 £m	2019 £m
The defined benefit obligation is made up as follows:		
Active members	(5,915)	(6,253)
Deferred pensioner member	(1,358)	(1,455)
Retired members	(3,128)	(3,480)
Present value of defined benefit obligation	(10,401)	(11,188)
Fair value of scheme assets	6,951	6,912
Deficit in the scheme	**(3,450)**	**(4,276)**
Group's share (60%) of the scheme deficit recognised in the balance sheet	**(2,070)**	**(2,566)**

This amount is presented as a non-current liability in the balance sheet. Cumulative gains or losses are recognised in equity.

Notes to the financial statements continued

26. Retirement benefit schemes continued

Movements in defined benefit plan assets and liabilities (including members' share):

	Asset* £m	Liabilities** £m	Deficit £m
At 31 March 2018	**6,457**	**(10,308)**	**(3,851)**
Current service cost including members' share	-	(445)	(445)
Interest on pension deficit	154	(245)	(91)
Section amendment (Past Service Costs)	-	(11)	(11)
Administration expenses	(13)	-	(13)
Return on plan assets greater than the discount rate	346	-	346
Actuarial gain arising from experience adjustments	-	81	81
Actuarial loss arising from demographic assumptions	-	-	-
Loss on DBO - financial assumption		(476)	(476)
Regular contributions by employer	112	-	112
Contributions by employees	72	-	72
Benefits paid	(216)	216	-
At 31 March 2019	**6,912**	**(11,188)**	**(4,276)**
Current service cost including members' share	-	(494)	(494)
Interest on pension deficit	158	(255)	(97)
Section amendment (Past Service Costs)	-	-	-
Administration expenses	(13)	-	(13)
Return on plan assets greater than the discount rate	(73)	-	(73)
Actuarial gain arising from experience adjustments	-	57	57
Actuarial loss arising from demographic assumptions	-	351	351
Gain on DBO - financial assumption	-	902	902
Regular contributions by employer	118	-	118
Contributions by employees	75	-	75
Benefits paid	(226)	226	-
At 31 March 2020	**6,951**	**(10,401)**	**(3,450)**

*Including CARE scheme assets at 31 March 2020 of £257m (2019: £250m)
**Including CARE scheme liabilities at 31 March 2020 of £587m (2019: £595m)
The actual return on scheme assets was £85m (2019: £500m).

Scheme assets

The asset values disclosed below reflect Network Rail's exposure to underlying asset classes through holdings of units of the pooled funds in which the underlying assets are held. Underlying assets are managed by the pension administrator, RPMI and the control over economic benefits for Network Rail established through the unitisation of those funds. The table below has been used to illustrate the underlying assets proportional to Network Rail unit holdings in various pooled funds, and their position in the fair value hierarchy of the underlying assets.

Level 1 and 2 assets include diversified Exchange Traded Funds valued at open trading prices; the Level 3 include property, private equity and non-exchange-traded Pooled Investment Vehicles equity. Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs) and therefore are inherently more subjective than Level 1 and Level 2 assets.

26. Retirement benefit schemes continued

	2020			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
RPS Scheme				
Pooled investment vehicles	-	297	-	297
Private equity and non-exchange-traded pooled investment vehicles	-	-	1,757	1,757
Cash and current assets	1,021	-	-	1,021
Equities	2,681	-	42	2,723
Fixed interest securities	192	43	22	257
Derivatives - Futures	27	-	-	27
Derivatives - FX contracts	-	(106)	-	(106)
Index linked securities	224	-	-	224
UK Property	-	-	494	494
Total Assets RPS Scheme	**4,145**	**234**	**2,315**	**6,694**

CARE Scheme	
Growth assets	152
Government bonds	60
Non-Government bonds	26
Property	8
Other assets	11
Total assets CARE Scheme	**257**
Total scheme assets	**6,951**

As a result of the economic uncertainty following measures undertaken as a result of the global pandemic, the Private equity and non-exchange traded pooled investment vehicles have required additional activity to assess their value at 31 March 2020. If the valuation was 5 % higher or lower this would decrease/ increase the retirement benefit obligations by £88m.

The group is exposed to a number of risks relating to the scheme including assumptions not being borne out in practice. The most significant risks are as follows:

Asset volatility
There is a risk that a fall in asset values is not matched by corresponding reduction in the value places on the defined benefit obligation scheme (DBO). The scheme holds a proportion of growth assets, which are expected to outperform corporate and government bond yields in the long term but gives exposure to volatility and risk in the short-term.

Change in bond yields
A decrease in corporate bond yields will increase the value placed on the scheme DBO, although this will be partially offset by an increase in the value of the scheme's corporate bond holdings.

Inflation risk
The majority of the scheme's DBO is linked to inflation where higher inflation will lead to higher value being placed on the DBO. Some of the scheme assets are either unaffected by inflation or loosely correlated with inflation (e.g. growth assets), meaning that an increase in inflation will generally increase the deficit.

Life expectancy
An increase in life expectancy will lead to an increased value being placed on the scheme's DBO. Future mortality rates cannot be predicted with certainty.

Actuarial assumption sensitivity
The discount rate is set by reference to market conditions at the reporting date, and can vary significantly between periods.

The earnings increases are linked to inflation and so set by reference to market conditions at the reporting date.

The mortality assumptions used are set by considering the experience of the scheme's members, and by making an allowance for possible future improvements in longevity. Mortality assumptions are difficult to set accurately and forecasting rates of future mortality improvement is inevitably speculative.

26. Retirement benefit schemes continued

Expected future benefit payments from the Network Rail Section, based on data from the 2013 formal valuation and the 31 March 2020 IAS19 assumptions are as follows:

	£m
Benefits expected to be paid within 12 months	176
Benefits expected to be paid between 2 to 3 years	363
Benefits expected to be paid between 4 to 6 years	637
Benefits expected to be paid between 7 to 10 years	1,024
Benefits expected to be paid between 11 to 15 years	1,551
Benefits expected to be paid in over 15 years	10,776

The following table shows the effect of changes in these assumptions upon the defined benefit obligation:

	2020 £m	2019 £m
Discount rate		
Change in defined benefit obligation at year end from a 25 basis points increase	(547)	(603)
Change in defined benefit obligation at year end from a 25 basis points decrease	590	651
Mortality		
Change in defined benefit obligation from a one year increase in longevity	322	332
Change in defined benefit obligation from a one year decrease in longevity	(322)	(329)
Earnings increase		
Change in defined benefit obligation at year end from a 25 basis points increase	152	172
Change in defined benefit obligation at year end from a 25 basis points decrease	(147)	(166)
Price inflation (CPI measure)*		
Change in defined benefit obligation at year end from a 25 basis points increase	555	619
Change in defined benefit obligation at year end from a 25 basis points decrease	(517)	(576)

* Including consistent increases to Retail Price Index, salary growth and Retail Price Index/ Consumer Price Index related pensions assumptions.

27. Related parties

The Department for Transport (DfT) and Transport Scotland (TS) are considered related parties of Network Rail. Network Rail received grant income of £4,936m from the DfT in the year ended 31 March 2020 (2019: £3,786m). Network Rail received grant income of £323m from TS for the year ended 31 March 2020 (2019: £339m). The total of this income is “Grant income” in Note 3. In the current year, the group did not pay any Financial Indemnity Mechanism fee to DfT (2019: £266m) (see note 25 for more details). At 31 March 2020 the company held £29,834m of loans issued by DfT (2019: £30,580m).

The British Transport Police (BTP), with whom Network Rail has a Police Service Agreement is also a related party. Network Rail incurred £92m (2019: £91m) of costs relating to services provided by the BTP in the year ending 31 March 2020 and received £1m (2019: £1m) in property income from the BTP in the same period.

Network Rail is also a related party of High Speed 2 (HS2). At the end of the financial year Network Rail held £201m (2019: £38m) of capital work in progress relating to works on HS2 and had also received £219m (2019: £63m) of capital grants that was recorded against property, plant and equipment.

East West Rail (EWR) is also a related party of Network Rail. During the year ended 31 March 2020, Network Rail received income of £0.3m from EWR for the provision of feasibility studies and development activities services.

28. Post balance sheet events

As at the date of signing these financial statements there have not been any significant post balance sheet events, whether adjusting or non-adjusting.