

Delivering for you



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Network Rail helps bring the country together. We own, operate and maintain Britain's rail network, increasingly delivering improved standards of safety, reliability and efficiency. Our investment programme to enhance and modernise the network is the most ambitious it has ever been. Delivering a 21st century railway for our customers and society at large.

Every day. Everywhere.

Meeting the challenges of success

In 2007/08 demands on Britain's rail network increased across all sectors – commuting, inter-urban, long distance and freight. The railway is the busiest it has been since 1946. The challenge facing everyone in the railway industry is to manage further growth and respond to changing travel patterns.

Network Rail has achieved a great deal since the Company took responsibility for the network in 2002.

Britain has the fastest growing railway in Europe. Passenger numbers and freight volumes continue to grow every year with over 1.2bn passenger journeys made in 2007.

Safety has improved every year. The railway continues to be the safest form of transport in Britain and the accident frequency rate for our workforce is the lowest it has ever been.

Punctuality has also improved. It is now the best it has been since records started in 1996.

And all this has been achieved while driving out costs at a rate that has delivered a 23 per cent improvement in efficiency over the last four years.

But success has created its own challenges. The railway currently carries around three million people every weekday; this is forecast to grow to some four million within 10 years. We have to correct decades of underinvestment in

maintenance and renewals, we also have to enhance the network to manage this growth. This year our £4bn investment programme delivered around 5,000 major projects across the network. Over the next five years the number, size and complexity of these projects are set to increase dramatically.

Everyone involved in the GB rail industry has a clear vision of the future: a bigger, better and higher performing railway. Our challenge is to deliver this vision. On time. On budget. And with minimum disruption to those using the railway.



Our performance

Safety

Rail travel continues to be the safest form of transport in Britain

During 2007/08 there were no train accidents resulting in fatalities to people on board trains and there was a 13 per cent reduction in the rate of 'significant train accidents' (collisions and derailments). Safety also improved for workers on the railways, although live track working remains hazardous. Despite a continuous drive to improve safety, sadly there were two workforce fatalities during the year.

The most significant area of risk on the railways is around level crossings. There were eight fatalities involving occupants of vehicles on level crossings during the year. This is five fewer than in the previous year but each one is a tragic event and we remain focused on educating users of the dangers associated with level crossings.

9th year

There were 181 broken rails in the year, the lowest annual total ever. Better inspection techniques, new track and relatively mild weather all contributed to the ninth consecutive year of improvement for this key safety indicator.

14%

We are focused on improving safety for those who work on the railways. Last year's accident frequency rate of 0.226 accidents per 100,000 hours worked is the lowest level ever and represents a 14 per cent improvement on the previous year.

Reliability

Train punctuality continues to improve

Britain's railway is a complex network. Some three million passengers made over 1.2bn journeys last year. Improvements in performance are driven by the investments and hard work of everyone involved – the train and freight operating companies, infrastructure contractors and ourselves. 2007 showed reliability improvements in all key metrics.

22,000

Around 22,000 trains are currently run each weekday – that represents a near 30 per cent increase since privatisation.

89.9%

By the end of 2007 train punctuality reached 89.9 per cent – the highest figure in recorded history. We anticipate exceeding 90 per cent this year.

10%

During the year there were some 9.5m delay minutes attributable to Network Rail. This represented a ten per cent improvement on the previous year and was well ahead of the Office of Rail Regulation's (ORR) target.

Financial highlights

for the year ended 31 March 2008

	2008 £m	2007 £m
Revenue	5,960	5,795
Operating profit	2,424	2,290
Profit before tax	1,588	1,474
Profit after tax	1,183	1,032
Net cash from operating activities	2,434	2,428
Net debt	(19,760)	(18,415)
Net assets	6,551	5,055
Railway network fixed assets	31,443	28,304
Investment property	949	948
Capital expenditure	3,952	3,326

Efficiency

Running an affordable railway remains our key financial focus. Achieving better cost efficiency enables us to invest more in enhancing the railway network

We continue to drive down the costs involved in running the railway. This year alone a further £178m in real terms was cut from the cost base. At the same time we continued to invest around £4bn a year in renewals and enhancements. The results can be seen in the improvement of the asset stewardship index (a measure of the reliability of our railway assets).

£1.2bn

£1.2bn profit for the year. All of this is being invested in the railway.

£178m

A further £178m in real terms was cut from the annual cost of running the railway.

£1bn+

In 2007/08 over £1bn was invested in network enhancements. £0.5bn more than in 2006/07.

People
35,000 people delivering day and night

Our 35,000 people not only enable the railway to run more safely, efficiently and reliably, they also deliver some 5,000 individual engineering projects a year to enhance the network. Overrunning engineering works at Rugby, Liverpool Street and Shields Junction at the beginning of 2008 damaged our reputation, but every day, every weekend, every bank holiday, our people deliver hundreds of similarly demanding projects with the minimum of disruption.



Safety is our number one priority

160,000

During 2007/08 we delivered 160,000 vocational training days to our people.

£23m

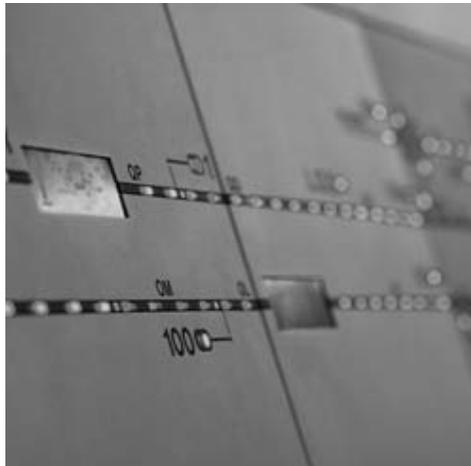
We spent £23m on training for our people.

5,000

We delivered 5,000 individual engineering projects during the year.

£3.9bn

We invested £3.9bn in the railway.



Chairman's statement



Ian McAllister, Chairman

Network Rail will deliver a £30bn investment programme to grow capacity on the network

This is an exciting time for Britain's railways, and for Network Rail itself, as we look to build on the successes of the last five years for the Company and the industry as a whole.

Network Rail has now owned and operated Britain's railway for more than five years, and over that time the railway has been transformed. It is safer than it has ever been. More trains are running than ever before. Average punctuality for the year, at 89.9 per cent, is the highest since records began in 1996. Passenger journeys are at their highest level for more than 60 years. Cost efficiencies of 23 per cent have been delivered. Meanwhile, investment in the network has grown and, over the next five years, it will double and then double again. I am proud of the part Network Rail has played in these successes, but it is also a record of which the whole industry can be proud.

During the past year performance and safety across the network has continued to improve and grow, and the cost of running the railway has continued to fall. The year has also been free of passenger fatalities and the key safety indicators continue to improve, with the railway recognised as the safest form of transport. Since Network Rail was established the number of broken rails has been reduced by over 50 per cent.

I pay tribute to two colleagues who have lost their lives this year. Their tragic deaths remind us of the difficult nature of the work carried out by Network Rail's people all year round. I thank them all for the valuable work they do. Notwithstanding these two terrible incidents, huge strides have been made in recent years to improve safety for those both working on and using the railway.

Our customers, the train and freight operating companies, make a huge contribution to helping deliver greater levels of reliability and a better railway overall. I am delighted with the work Network Rail has been able to undertake in partnership with our customers throughout the year and across the country to improve the network for passengers and freight users alike.

By the end of March 2009 the cost of running the rail network will have fallen, in real terms, by around a third in five years. However, in 2007/08, for a number of factors, Network Rail's financial efficiency target has not been reached. This is disappointing, but should not detract from the progress that has been made since 2002 in controlling costs. Our plans for the next five years would see the overall cost of the rail network fall by almost half, in real terms, in a decade. By any standards, this would be a remarkable achievement. Alongside this Network Rail will deliver a £30bn investment programme to grow capacity on the network to meet the increasing demand for rail.

All those of us involved in the industry can be proud that rail is now a success story. Three million passengers use the railway every weekday. Freight volumes have risen dramatically. Every forecast expects this growth to continue in the years to come. The industry must respond to this success, and grow the railway to meet the ever-increasing demand from its users.

Three million passengers every weekday are choosing rail

In July, the Department for Transport published its White Paper 'Delivering a Sustainable Railway'. This outlined the Government's 30-year strategic vision for the railway of England and Wales. As part of this vision, the Department also set out in detail what it wants the industry to deliver in the five years from April 2009. The Scottish Executive published the same for Scotland. In October, Network Rail published its Strategic Business Plan. This was developed in partnership with the whole industry, and contained ambitious plans to grow the railway, to improve performance across the network, to make rail an even greener transport choice, to make the railway available more consistently across the week and to do all this while reducing costs even further.

The industry has made substantial progress, though the year has not been without its own challenges; in January, at Rugby, Liverpool Street and Shields Junction, overrunning engineering works led to huge disruption for passengers and freight users. At the time, rightly, Network Rail apologised. Importantly, many lessons were learned as a result of the internal and external investigations carried out. The regulator imposed a fine of £14m on Network Rail as a result of the overruns. The adversities the Company experienced on three lines in January, and the problems at Portsmouth earlier in the year which resulted in a £2.4m fine, were a stark reminder of the challenges that have to be faced as we rebuild and expand the railway. However, it is important to remember these were isolated cases in the context of the thousands of pieces of work carried out across the network throughout the year. Additionally, whilst I accept it may be of little consolation to those who experienced disruption at the time, the work undertaken will bring substantial benefits.

I am entirely confident that, in Iain Coucher and his Executive Team, Network Rail has the right people in place to meet the challenges ahead. I am also delighted to welcome Steve Russell to the Board as a non-executive Director. He brings valuable experience and I am sure he will make a substantial contribution in the years to come.

There are challenges ahead for Network Rail, but they are a result of the success of the last five years. The Company's record is one of genuine achievement. This year's financial results underline that achievement. Network Rail remains entirely committed to working with the whole industry to build on the successes of the last few years and to deliver a network which meets the needs of its users, both passengers and freight, and the nation as a whole.

Ian McAllister
Chairman
27 May 2008

Chief Executive's review



Iain Coucher, Chief Executive

This is my first annual review since becoming Chief Executive of Network Rail, in August 2007. The last 12 months have been an enormously exciting time for the rail industry, during which demand for rail has continued to grow in all sectors: commuting, inter-urban, long distance and freight. As an industry, we are now delivering the highest level of passenger journeys since 1946, and on a railway that has not seen significant expansion for decades.

The challenge for the rail industry and, therefore, Network Rail is managing a further growth in demand – not just in the numbers of people wishing to travel by train or putting freight onto the rail system, but responding to changes in travel patterns. The railway of the future needs to provide services earlier in the morning, later at night, and more at weekends and at bank holidays. This has huge implications for Network Rail.

During 2007/08, Network Rail has continued to deliver a more reliable and higher performing railway to our customers, the train and freight operating companies, reaching the lowest levels of delay minutes since 1999/2000. This has contributed to delivering the best levels of punctuality since records began in 1996. We have continued to make steady progress in removing costs from the operation of the railway.

I am proud of this record of achievement; we have a great team at Network Rail and it is the contribution of everybody at Network Rail that has enabled us to deliver this.

2007/08 represented a turning point for the industry. In July, the Government published its Rail White Paper, setting out the outputs for the rail network in England and Wales. The Scottish Executive also published the same, for Scotland. In October, Network Rail published its Strategic Business Plan, presenting how the rail industry, together, would deliver these outputs. These documents present a very clear vision of the future. This means a safer, bigger, better and higher performing railway. Every weekday, the railway carries around three million people; in the foreseeable future this will become four million. Freeing up capacity on the railway to allow this to happen will be key. In terms of performance, in the next five years we will push the reliability of the railway to levels never seen before in Great Britain.

Network Rail recognises the key role it plays in the delivery of a safe, efficient and reliable railway that forms part of an integrated transportation system. Millions of people depend upon the railway – to get to work, to visit family and friends and to travel the length and breadth of the country.

Britain's rail network is 'mixed use' – carrying passengers and freight at increasing levels. Network Rail recognises that freight operators are not franchises, but long term businesses that have invested accordingly. Rail freight brings tangible social and environmental benefits to society.

The challenge for Network Rail is clear: we need to provide a railway that is more available and more reliable. We need to manage annual, multi-billion pound investment programmes in a way that minimises the impact on those that wish to use the railway, and we need to continue to achieve further efficiencies, on top of the 23 per cent we have delivered in the last four years. However, this is a challenge we relish. The whole of Network Rail is determined to meet our vision: one in which passengers and freight users rate rail as the best mode of transport for overall safety, reliability, accessibility, convenience and value for money; and where Britain's railway is recognised by taxpayers as being amongst the best in the world for safety, reliability and affordability.

Safety

The Railway Safety and Standards Board (RSSB) published its Annual Safety Report in May 2008. This confirmed that there is no safer form of transport in Great Britain than rail. During 2007/08, there were no train incidents resulting in fatalities to people on trains.

There were, however, eight fatalities of occupants of road vehicles, due to trains striking vehicles at level crossings – down from 12 during the previous year. During the year, we continued with the 'Don't run the risk' public awareness campaign,

This year, Network Rail managed an investment programme totalling around £4bn

designed to educate users on the risks associated with level crossings and the dangers of misuse. This included a hard-hitting advert on prime-time television, supported by national and local media. Local radio, regional press adverts, outdoor posters and direct marketing were also used to target 'hotspots' of misuse.

During 2007/08, the 'accident frequency rate' for our workforce has improved to the lowest ever level – now 0.226 accidents for every 100,000 hours worked. This represents a 14 per cent improvement over the previous year, and a 55 per cent reduction since Network Rail was established. However, it saddens me to report that, during the year, there were two workforce fatalities. On 19 April 2007, a welder died when struck by a train whilst undertaking maintenance work at a crossing near Reading. On 29 November, another maintenance worker died when struck by a train, in the middle of the night, at Kennet Bridge. These tragic incidents provide a salutary reminder that, despite improving trends, there can be no room for complacency in our drive to improve safety.

Last year, we reported a substantial improvement in the number of broken rails. That improving trend has continued with 181 broken rails in 2007/08. This is, once again, the lowest annual figure ever – beating the 192 in the previous year and 317 in the year before that, and it means the total has been halved since Network Rail took over the network. This has been as a result of continued investment in new track, better inspection techniques and a mild winter.

Performance

The dramatic improvements in punctuality seen over the last five years have continued. By the end of the year, punctuality of trains reached 89.9 per cent, ahead of the target of 89.5 per cent.

In terms of 'delay minutes', there was a 10 per cent improvement over the previous year – equivalent to 1m delay minutes – and we finished the year with a final figure of around 9.5m delay minutes attributable to Network Rail. The assets on the railway are now performing at or around the best level for a decade and performance is well ahead of the target set by the Office of Rail Regulation.

Many of the improvements in performance stem directly from the work we do, in partnership, with our customers and we are grateful for the support we receive to deliver an improving railway.

And despite the fact the railway was designed for a different time and for a different use; and despite the age of many of the assets on the railways, we now have a rail network that can be depended upon to deliver over 1.2bn passenger journeys a year.

Growing the railway

After decades of underinvestment, Network Rail is in the position of having to cope with a backlog of renewals, and having to deliver the capacity to meet future growth. This year, Network Rail managed an investment programme totalling around £4bn – probably the biggest and most complex capital investment programme of any company in the UK. We deliver around 5,000 separate major projects on the network, every year. Each one requires careful planning, sometimes years and months in advance, but also demands meticulous execution in just a few days.

The work to upgrade the lines from London Euston to Rugby, Birmingham, Manchester, Liverpool and onwards to Scotland nears completion. This multi-billion pound scheme will provide fast, frequent, efficient and modern rail services for millions of people.

We are now planning a dramatic increase in the number, size and complexity of schemes for the next five years – each one designed to bring significant passenger benefits. Programmes such as Thameslink, Airdrie-Bathgate, Reading station, King's Cross station and Birmingham New Street station will transform the travel experiences of the millions of people who use the railway. But in addition to these big, high-profile schemes, most of our work to enhance the railway consists of relatively small schemes – work to allow longer trains, more trains and faster trains.

In October, three months after the Government gave the go-ahead for the Thameslink Programme, the £5.5bn project got underway with the work to lengthen the platforms at Luton Airport Parkway.

The dramatic improvements in punctuality seen over the last five years continued in 2007/08

Since funding was approved a great deal of other preparatory work has been underway including the final stages of appointing the main contractors for the major works required at Blackfriars, Borough Viaduct and Farringdon. When phase 1 is completed by the end of 2011 this will allow improved capacity on the North/South Thameslink route from the current eight trains per hour to 16 trains per hour. During peak periods trains will increase to 12 from eight car trains.

In 2007/08, Network Rail delivered over £1bn of enhancement investment on the railway, around £500m more than in 2006/07, a significant proportion of this being funded by third parties.

Improving the assets

There have been further improvements in asset reliability over the year. Points and track circuit failures reduced by 14.9 per cent to 14,498 and, overall, asset failures fell by 9.9 per cent to 52,476. A number of initiatives have played their part in this success. These include the continued and increased use of joint point care teams, local coaching and mentoring of frontline staff by engineers and a focus at a local level on understanding the root cause of asset failures, and particularly repeat failures. In short, though, it has been about always looking for ways to do our day job better.

In addition, the 'asset stewardship index' target was beaten once again during 2007/08, and marked another significant improvement on the previous year. A number of initiatives over the year have contributed to improving asset performance, including standardised designs driven by our in-house design group and an increased use of modular components. Improvements made to the way we deliver our work have helped us reach a stage where temporary speed restrictions are at the lowest levels ever recorded.

Costs and finance

The need to run an affordable railway network remains a priority and Network Rail continues to strive for greater levels of cost efficiency. By achieving increased levels of efficiency, resources will become available to invest in growing the railway network.

The ORR has challenged Network Rail to deliver efficiencies of 31 per cent over the five year Control Period ending 31 March 2009. The Company is striving to meet this challenge and has already achieved a 23 per cent reduction by 31 March 2008. These savings include 29 per cent on controllable Opex (Control Period to date target 26 per cent), 31 per cent on maintenance (target 28 per cent) and 18 per cent on renewals (target 26 per cent).

In the year to 31 March 2008 operating costs before depreciation fell by £73m or £178m in real terms. This builds on improvements made over the first three years of the determination.

As the cost base of the Company contracts, driving out further efficiencies becomes more difficult. This is particularly the case with track renewals. Although unit costs are falling in real terms they are not reducing quickly enough to meet the tough targets set for the Company five years ago. The year under review has seen an overall reduction in renewals efficiencies (from 23 per cent to 18 per cent). We continue to focus on addressing this issue but it is clear we will not meet the renewals efficiencies challenge for this Control Period, in particular the area of track renewals. This does have to be seen in the context of efficiency gains in the round.

The savings made have contributed to profits of over £1bn, as detailed in the Group Finance Director's review on page 10. This is in line with the business plan for the year. Network Rail has no shareholders so profits are not distributed, but reinvested in the railway network.

Network Rail invested a record £4bn in the railway network during the year using all the profit generated, and more, to fund these projects. This high level of investment continues to improve punctuality and asset condition.

Delivering such large levels of investment has not been without problems. The disappointing New Year overruns resulted in an ORR fine which in turn contributed to narrowly missing the Company's financial efficiency target. That aside, financial efficiency has improved by five per cent on the previous year's performance.

Network Rail has one of the biggest capital investment programmes in the UK and we continue to win praise for the way we finance that investment through our debt issuance programme. As we mature as a company we continue to develop the way we raise our finance. In April 2007, we launched our highly successful index-linked debt programme and we have already issued £3.4bn to a wide range of UK and international institutions. Looking forward, we continue to work with the ORR and DfT in developing our plans to raise corporate debt in the next Control Period without a government indemnity.

It has also been an excellent year for the Commercial Property team which generated a profit of over £250m to improve the railway. Despite a challenging market place better than market growth has been achieved from our retail assets and our Spacia estate. The development and sales activity is being transformed from a sales organisation to one delivering, through partnerships, mixed use development that will create excellent facilities for passengers and train operators and improved financial returns for Network Rail.

Challenges

It is important I acknowledge the negative aspects of the year. Network Rail was in the news for all the wrong reasons at the start of 2008, when overrunning engineering work at Rugby, Liverpool Street station and at Shields Junction, just outside Glasgow caused

significant disruption to passengers and freight users. I would like to reiterate what I said at the time: the disruption was unacceptable and damaged the reputation of Network Rail and of the rail industry.

The industry has worked exceptionally hard over recent years to create a rail service upon which people can depend. And Network Rail has played a full and important part. This is the context – a context of an excellent track record of delivery – in which these overruns occurred. Network Rail remains a good company, but we recognise the adverse effect these events had upon our reputation.

Every day, every weekend and at every bank holiday, we are under great pressure to deliver incredible volumes of work in extremely short periods. Every one of the 5,000 projects we execute or, indeed, any maintenance activity we undertake has the potential to cause disruption if we do not complete in time. Network Rail has a good record of delivery, but we have got it wrong in a number of locations, this year.

But we are a learning organisation and we will learn lessons. A number of investigations have been concluded and we have made a number of changes to our processes, all designed to minimise the chances of disruption to the travelling public.

The easy answer would be to take more time to do the work. This would be the wrong way forward, as it would reduce the availability of the railway for passengers and freight users. When our activities become visible, as they did over the New Year period, it means we have not done our job properly. Our measure of success is invisibility – to get in, do our work and get out again without rail users noticing.

Conclusion

I was honoured to follow in the footsteps of John Armit, and become the second Chief Executive of Network Rail. As Deputy Chief Executive, I worked with John to stabilise the Company and to create the strong, profitable and successful company that is Network Rail today. I had a great opportunity to watch and learn from a consummate and professional leader.

My challenge is to take this Company on the next phase of its journey; to become a world-class, customer-focused, infrastructure manager and to build a safer, bigger, better and higher performing railway.

With our people and our values – our determination to improve the railway, our respect for the environment and communities in which we work, our teamwork, as well as our passion and pride in what we do – we are well placed to meet the challenge.

Iain Coucher
Chief Executive
27 May 2008

Group Finance Director's review



Ron Henderson, Group Finance Director

This has been another year of financial stability and efficiency

The year ended 31 March 2008 has seen stable profitability, with consistent revenues and costs continuing on a downward trend. The reduction in the running costs of the railway has been delivered by our regime of strong budgetary control, together with our improved understanding of the cost bases and cost drivers.

This high level of predictability has further assisted us, together with our prudent treasury policies, in ensuring that there is strong control over our funding and related finance costs.

Whilst great progress has been made in reducing costs in most areas (with Opex and maintenance ahead of target), it is clear that the pace of unit cost efficiency in the area of track renewals is behind schedule and will cause us, for the first time, to fall behind our targeted efficiencies. Consequently it looks likely that we will miss the Office of Rail Regulation's (ORR) overall challenge of 31 per cent reductions by 31 March 2009.

Although it is disappointing that not all the regulatory cost targets will be met, we remain committed to building on the strong foundations that have been put in place to produce an increasingly cost effective railway. Our recently published Strategic Business Plan update set out how we intend to continue to manage a reliable, punctual, safe and expanding railway network in a financially efficient and viable manner.

Financial performance

Financial highlights

- turnover was £5,960m, an increase of £165m against prior year turnover of £5,795m
- operating costs before depreciation totalled £2,389m, a decrease of £73m compared to the prior year total of £2,462m and a reduction in real terms of some £178m

- profits of £62m were achieved from the sale of properties (2006/07: £47m)
- net interest charges (finance costs offset by investment revenues) have risen marginally to £903m from £893m last year, despite increases in net debt levels. This has been achieved by obtaining comparatively higher returns on surplus funds raised in advance of refinancing the £1.3bn of debt that matured in March 2008. Net debt increased to £19.8bn from £18.4bn in the year
- total non-current assets have increased from £29.4bn to £32.6bn
- net assets at 31 March 2008 totalled £6.55bn (2006/07: £5.06bn).

Performance against the ORR Control Period 3 determination

The table below outlines the outturn on the key areas of expenditure in 2007/08 prices for the business as defined within the Access Charges Review 2003.

The overall ORR challenge was to produce combined efficiencies of 27 per cent for operating, maintenance and renewals costs in the first four years of the Control Period. The current outturn based on the above results is a saving of 23 per cent with good performance in both controllable Opex and maintenance. Overall renewal efficiencies have reduced over the year and are now at 18 per cent against an ORR four year target of 26 per cent. Aside from track renewals improvements in signalling, electrification and plant, civils and

Progress towards the ORR's 31 per cent target

Category	31.03.05 £m	31.03.06 £m	31.03.07 £m	31.03.08 £m	Cumulative Progress
Controllable Opex	1,036	937	916	878	29%
Maintenance	1,410	1,291	1,195	1,118	28%*
Renewals (excluding West Coast)	1,794	2,166	2,522	2,534	18%
Overall efficiency (ORR year 4 target: 27%)					23%

* After accounting for the impact of traffic growth, the saving increases to 31 per cent.

These draft results will be incorporated in the forthcoming Annual Return 2008, a regulatory document planned for publication in August 2008 which is subject to review by the ORR's independent reporter.

estates are needed. Our focus is firmly on delivering improvements, both in the final year of this Control Period and going forward.

Controllable Opex and maintenance costs fell six per cent in real terms over the year. Controllable Opex costs produced a 4.1 per cent reduction in real terms despite the imposition of ORR fines for the Christmas and New Year over runs and the Portsmouth resignalling licence breach. Maintenance costs continue to reduce in real terms, a 6.4 per cent saving in the year, with more maintenance work being delivered for less money than in prior years. Expenditure has contracted through the favourable commercial terms negotiated in recent years, particularly on plant, vehicles and materials. Significant benefits were derived from improved labour utilisation as the capital investment portfolio delivered by the maintenance team increased by a further 37 per cent compared to 2006/07 with ten per cent of total investment now delivered in-house by the maintenance function. Further improvements in labour productivity were secured through the depot improvement programme. This enabled further release of contingent labour and specialist contractors.

The year under review delivered substantial investment with some £4bn of renewals and enhancements. The increasing use of innovative delivery and contracting mechanisms, as well as the contribution from high-output plant and equipment, is laying solid foundations to deliver further efficiencies in the medium to long term.

Our recently published Strategic Business Plan update focused on continuing high levels of investment in the network over the remainder of this regulatory Control Period and through into the next. In particular this outlined significant enhancement expenditure to improve train performance and increase capacity. During 2007/08 we spent over £1bn enhancing the network and plan to deliver a further £1.4bn in 2008/09.

We reported last year that we would struggle to meet the ORR target on track renewals and, as outlined above, the year under review has borne this out. Whilst significant progress has been made in improving the track renewals performance delivered by the Company and its supply base, it is recognised that further steps need to be taken to continue to drive performance onwards. These steps will build on some of the initiatives introduced over the past four years, such as high output mechanisation and future planned initiatives, such as modular switches and crossings.

For the year ahead we are committed to deliver the outputs of the West Coast Route Modernisation project aimed at improving travelling times, reliability and punctuality of the route. We have engaged the train operators in agreeing a revised plan for delivery of the December 2008 timetable for the West Coast. There is added pressure on the project budget and we are working through the final cost implications. It is evident though that the final project cost will be in excess of the £8.45bn as set out in our Strategic Business Plan.

Key performance indicator – financial efficiency index

This year the Company marginally failed to deliver its targeted Financial Efficiency Index (FEI). The FEI is a weighted index of controllable Opex, maintenance, track renewals and major resignalling schemes which broadly measures the value for money of the Company's spend in relation to prior years. The index's coverage has also widened since last year.

The final FEI at 31 March 2008 stands at 78.1, which despite being worse than target is still an actual improvement of some 5.0 per cent on the prior year. This includes the impact of the ORR fines, excluding which the FEI would have been 77.7, a reduction of 5.5 per cent and better than the target for the year.

Carrying value of the railway network

The value of railway fixed assets has increased by £3.1bn from £28.3bn to £31.4bn. The increase in the carrying value reflects capital expenditure of £4.0bn less depreciation of £1.2bn and an upwards revaluation of £0.4bn.

Under depreciated replacement cost accounting the network is valued in the accounts at the lower of its same state replacement cost (which is estimated at circa £63bn) and its value in use. This value in use is based on a discounted future cash flow that assesses the value to the business of the net income stream produced by the railway network. This is a function of the Regulatory Asset Base (RAB) set by the ORR and, as such, this RAB is used as a proxy for that value together with appropriate adjustment for any forecast cash flow variance from the determination.

In addition, investment properties (2007/08: £949m, 2006/07: £948m) experienced a reduction in their market value of £28m in the year, but this loss was offset by a transfer from operational properties of £21m and net investment in existing properties of £8m.

Pensions

Included within the Income statement for the period is a charge of £107m (2006/07: £104m) in respect of pension costs of which £126m (2006/07: £121m) represents service costs and £19m (2006/07: £17m) is a net interest return on assets. The Balance sheet liability, which represents the Company's share (60 per cent) of the deficit of the Network Rail section of the Railway Pension Scheme (RPS), increased by nearly 50 per cent from £248m to £370m. The main driver for the increase in the accounting deficit has been an assumed increase in longevity in the consultation proposals for the actuarial funding valuation which reports the overall position of the scheme. The RPS actuary, Watson Wyatt, intends to publish this valuation in September this year.

Taxation

Of the tax charge in the Income statement of £405m (2006/07: £442m), all bar £6m (2006/07: £10m) is deferred tax. Deferred tax is provided on differences in timing with regard to recognising gains and losses for tax purposes and accounting purposes. The current tax payable relates primarily to profits from the Group's property portfolio.

The charge in the Income statement indicates an effective rate of tax of 25.5 per cent. This is less than the current corporation tax rate of 30 per cent or the 2008/09 rate of 28 per cent because of an adjustment to the prior year deferred tax position from 30 per cent down to the 2008/09 corporation tax rate.

The Government's 2007 budget proposed changes to phase out Industrial Buildings Allowances over a four year period from 2008. As this legislation has not yet been enacted the impact on deferred tax has not been reflected in the accounts. It is estimated that if the legislation had been enacted already there would be an increase in the deferred tax liability of approximately £380m.

Cash flow and funding

During the year the Group's operating activities generated cash of £2.4bn (2006/07: £2.4bn). This went a long way to funding the investment programme, on which £3.5bn (2006/07: £3.3bn) was spent, in net cash terms, in the year.

Network Rail's principal financing vehicle is Network Rail Infrastructure Finance PLC (NRIF), a special purpose financing company, which acts as the issuer under Network Rail's Debt Issuance Programme (DIP) and is not a member of the Network Rail group, although for accounting purposes NRIF is treated as a subsidiary in the consolidated accounts of Network Rail Infrastructure Limited.

The DIP is supported by a financial indemnity from the Secretary of State for Transport which expires in 2052. As at 31 March 2008, substantially all Network Rail's debt sits under the DIP other than £3.9bn equivalent of medium term notes which sit under Network Rail MTN Finance PLC. Within the DIP is a £20bn note programme which has been highly rated (AAA by Fitch, Aaa by Moody's and AAA by Standard & Poor's).

In April 2007 Network Rail launched a new programme of RPI index-linked bond issuance under the Company's debt issuance programme. The majority of Network Rail's revenues are linked to inflation so aligning debt cost to income is a prudent, cost effective way of financing the railways over the long term.

During the year ended 31 March 2008 £3.9bn of bonds have been issued under the DIP, £3.4bn of which was long dated inflation linked. As with all previous non-sterling public issuance under the programme the \$1bn bond was swapped into fixed sterling interest rates to protect against movements in interest and foreign exchange rates.

The Company had £5bn of undrawn committed facilities available at 31 March 2008 through the DIP working capital facility (£1bn) and the Secretary of State for Transport standby facility A (£4bn). The Secretary of State for Transport standby facility is undrawn but will only be called upon as a last resort.

Financial instruments

The Group uses derivative financial instruments to reduce exposure to foreign exchange risk and interest rate movements. This is in accordance with a comprehensive risk management process which is monitored by the Board and includes documented treasury policies, counterparty limits, controlling and reporting structures.

Derivative financial instruments are marked to market in accordance with IAS 39 and their value is shown on the face of the balance sheet. Those that are designated as part of a cash flow hedge accounting relationship are measured for effectiveness in removing foreign exchange and interest rate risk. These movements are reflected in the hedge reserve and shown on the face of the Statement of recognised income and expense (SORIE). It should be noted that changes in the value of a hedging derivative should theoretically mirror movements in the value of the underlying hedged item.

Instruments not qualifying for hedge accounting and ineffective portions of cash flow hedge relationships are recorded in the Income statement. The Group has successfully implemented hedge accounting for its Medium Term Note and Debt Issuance Programme bonds. The net fair value of derivatives on the Group's Balance sheet at 31 March 2008 was an asset of £276m (2006/07: liability of £262m) based on a notional value of swaps of £10.3bn (2006/07: £11.8bn).

The net impact on the Group's Income statement of IAS 32 and IAS 39 in the year ended 31 March 2008 was income of £33m (2006/07: expense of £25m) and a negative movement in the SORIE of £23m (2006/07: gain of £168m). This SORIE movement reflects the Group's cash flow hedges increasing in value by £370m, due primarily to a decline in the value of sterling against the Euro, off-set by £393m of foreign exchange losses in the underlying hedged debt.

The reason that the gains and losses in the accounts are not equal and opposite is that the hedging instrument protects against movements in interest rates as well as foreign exchange. It follows that if the value of the derivative was split into its constituent parts it would show broadly that £393m of foreign exchange losses were avoided by hedging, but around £23m of additional interest was payable as a result.

Treasury operations

The Group's treasury operations are co-ordinated and managed in accordance with policies and procedures approved by the Board which prohibit trades of a speculative nature. The Treasury department is subject to regular reviews by internal audit.

Group policy is to ensure that there are sufficient facilities (excluding re-financing of existing debt) and short-term investments to cover, as a minimum, the next 12 months' funding requirements.

The major financing risks that the Group faces are its foreign exchange risk, interest rate fluctuation risk and liquidity risk. Treasury ensures sufficient liquidity is available to meet the Group's needs, while reducing financial risks and prudently investing surplus cash.

Counterparty limits are set with reference to published credit ratings. These limits dictate how much and for how long Treasury may deal with each counterparty and are monitored on a regular basis.

Summary

This has been another year of financial stability and efficiency. The Group has delivered further profits to enable both investment in the railway network and effective debt management. Cost savings continue to be made and the Group continues to invest heavily in the railway network. It is in the area of renewals that meeting the efficiency targets has proved most challenging and the Group is fully committed to addressing this issue.

Significant effort and focus is being given towards securing a fair and positive determination for the next Control Period that will benefit the Company and the entire industry. This will further secure the long term reliability, viability and competitiveness of the railway.

The year under review delivered substantial investment with some £4bn of renewals and enhancements

Ron Henderson
Group Finance Director
27 May 2008

Directors' report

Whilst not required by law or regulation, the Company has undertaken, so far as it is practical having regard to its corporate structure, to comply with the principles of good corporate governance and code of best practice under, or approved for the purposes of, the listing rules of, the Financial Services Authority. As such, it is publishing this Report and audited Accounts which contain information required to be disclosed by a listed company.

In addition, under its network licence, Network Rail Infrastructure Limited is also required to publish such corporate governance information and, therefore, it too is publishing its Report and Accounts for the same period.

Details of the Group's business activities, key events and changes during the year and likely future developments are contained in the Chairman's statement, the Chief Executive's review and the Group Finance Director's review. This report should also be read in conjunction with the Corporate governance report and the Directors' remuneration report.

Business review and principal activities

Network Rail Limited is the ultimate parent company of the Group which includes Network Rail Infrastructure Limited, its principal operating company.

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

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

In June 2005 the relevant provisions of the Railways Act 2005 came into force facilitating a number of significant changes to the structure and organisation of the railway. These included giving Network Rail Infrastructure Limited additional responsibilities for industry performance, planning and projects. The changes are designed to deliver improvements in reliability and the effectiveness of industry planning, building on the already close collaboration between Network Rail and train operators.

Significant events subsequent to 31 March 2008

On 4 April 2008 Network Rail published its Strategic Business Plan update providing an update and further justification for elements of the Strategic Business Plan published by Network Rail in October 2007.

Results

The profit before tax was £1,588m (2006/07: profit of £1,474m) and the profit after tax was £1,183m (2006/07: profit of £1,032m). Further details of the financial results can be found in the financial statements commencing on page 44.

Share capital

Being a company limited by guarantee Network Rail Limited has no share capital.

Key future issues

Given the nature of its business and the environment within which it must meet the challenges involved, the key future issues for the Company remain those reported in the Annual Report for 2007.

General

Network Rail's key priority is to deliver a safe, reliable and efficient railway working with our industry partners to provide acceptable and improving levels of performance. Looking forward it intends to achieve further sustainable improvements for its customers, employees and wider stakeholders as well as seeking ways to meet where possible the increases in demand for both passenger and freight traffic.

With its responsibilities relating to the national rail network, Network Rail has a pivotal role in a complex industry. The way in which it looks after its assets affects a wide range of people and Network Rail works collaboratively with its customers and funders to facilitate the delivery of their plans. It needs also to work with its stakeholders to take account, where possible, of the wider social impacts of the operation of the national rail infrastructure. With a background of strong growth, improving

safety and sustained improvements across the whole rail industry, the next Control Period (CP4) presents a unique opportunity for continuing improvement in services for the benefit of passengers and freight users, the rail industry, taxpayers, the economy and the environment in which we live.

Of the issues facing Network Rail in the future the following continue to be key to the deliverability of its objectives:

Safety

Rail travel is safer than it has ever been and safety remains Network Rail's highest priority. Whilst rail continues to be the safest form of transport in Britain, there remains the need for constant vigilance in maintaining the safety of the railway. This is still at the forefront of the Company's focus.

Continuing improvement has been made in most of the key safety performance indicators. The risk from signals passed at danger is down by 87 per cent since 2001, due largely to the introduction of technology – TPWS and TPWS+. The number of broken rails continues to reduce to another all time low.

Tragically there were two workforce fatalities in 2007/08 notwithstanding a continuing reduction in the accident frequency rate for the business. The Company is committed to its focus on improving safety of travelling on the network and the safety environment for working on the railway including safer working practices. This is due in part to safety awareness campaigns focusing on raising the profile of safety within Network Rail and contractor teams, and other initiatives designed to develop safety cultural and behavioural changes. The workforce accident rate has declined markedly over the last four years and improved by a further 13 per cent in the past year. At the end of 2007/08 the rate was down to less than 0.226 reportable accidents per 100,000 hours worked.

Network Rail's 'Safety in the Line' programme was implemented during 2006/07. This is designed to embed safety accountability improvements and decision-making more fully into the key delivery functions within the Company. It represents the most significant component of Network Rail's strategy to deliver a continuing step change in safety performance.

The biggest risk on the railway is now at level crossings and during 2006/07 Network Rail launched a national level crossing awareness campaign. This campaign has been refreshed and developed since its launch and continues to be a major focus for the Company in assisting in addressing the need to heighten public awareness of the risks associated with misuse of level crossings by the public. Progress continues with the development of suitable new detection technologies to warn of vehicles obstructing a level crossing.

Service reliability and network capacity

Punctuality on the railway is the highest in recorded history. The average punctuality over the past year was 89.9 per cent. This has been achieved earlier than the target set by National Task Force for reaching 90 per cent before the end of the current Control Period (31 March 2009).

Achieving continued improvements in punctuality is, however, a challenge. Improvements to date are the result of the hard work of everyone involved in the operation and management of the railways – both Network Rail and the train operators. Joint planning and delivery processes between Network Rail and the train operators have contributed to this, as has the introduction of more integrated control centres. Improving productivity and effectiveness of maintenance activities have generally also assisted.

This improvement in punctuality has come about despite continuous increases in the number of train services using the network. The demand for rail has grown strongly over the last ten years for both passengers and freight services. This trend in passenger demand has continued over the past year with a growth in total passenger kilometres, total passenger journeys and revenue compared to the previous year. This

demand for rail travel has been reflected in the continued increase in timetabled train kilometres operated on the network. Likewise, both freight moved and lifted has mirrored past trends and grown over the past year.

As a consequence, the network remains increasingly congested and at peak times of the day there is no spare capacity on certain sectors of the network. Levels of overcrowding are worsening as a consequence of this demand. As well as the effect on train passenger capacity this demand is also creating increasing congestion on the station platforms and concourses.

For the longer term, Network Rail is developing plans with train operators and funders to increase capacity. Key to understanding the options to address these issues is the programme of Route Utilisation Strategies (RUSs) which Network Rail is taking forward in conjunction with its rail industry partners. These take a strategic look at the rail network and its timetable and form the analytical and consultation process by which options are evaluated to balance capacity, passenger and freight demand, operational performance and cost.

Implementing the necessary enhancements of the infrastructure to cope with the rising demand will require the industry to achieve a consensus on the right solutions. These solutions must offer good value for money and be affordable to funders. Proposals for this are set out in Network Rail's Strategic Business Plan published in October 2007 and the Strategic Business Plan update published in April 2008.

Asset stewardship

One of the major components of Network Rail's improvement plans is reliability and long term sustainability of the network. This requires successful delivery of Network Rail's asset management responsibilities within the constraints of the available funds as well as being consistent with the reasonable requirements of its stakeholders. Development and implementation of the asset management activities involves comprehensive understanding of the criteria and systematic organisation in their delivery. Focus is on tackling the root causes of long-standing issues that affect asset performance. In particular,

components that are not sufficiently reliable will be progressively replaced. The rate of improvement, however, will inevitably be slow. Once again this year's experience has shown that several of the measures for asset reliability are now at a level where the impact of adverse weather can significantly affect the performance measures. This provides both risk and opportunities with strategies being developed to minimise the effects of adverse weather wherever possible.

Recognising that some of the measures used to monitor asset stewardship may be nearing the end of their usefulness (because they are stabilising at optimum levels), Network Rail has continued its review (reported last year) of these measures to determine what will be more fit for purpose for the next Control Period. It is anticipated that these will measure precursors to failure, rather than failures themselves. This is in line with our strategy of 'predict and prevent' rather than 'find and fix'.

Efficiency

In the last four years efficiency savings of 23 per cent have been made with reductions in Network Rail's cost base.

Technological innovation is an integral part of improving the business. Network Rail continues the important work of engaging with European rail bodies to examine long term asset strategies, and working with suppliers and academia to explore climate change and sustainability improvements. It is also examining the opportunities afforded by improved communication technology and exploring the application to the railway of innovations developed in other industries.

Sustainability

Transport has a major role to play in supporting economic, environmental and social objectives. Given that rail transport itself is more sustainable than alternative modes for many transport needs, the rail industry must promote rail usage by improving the rail product and its affordability in order for it to contribute to sustainability. Work is progressing on this front in various areas.

Funding and financing

Network Rail's net debt was £19.8bn at 31 March 2008 and is forecast to increase to over £21.6bn by March 2009 being the end of this Control Period.

It is anticipated that funds required for this period will be raised through a combination of public and private bonds issued under the debt issuance programme to cover the refinancing of existing debt as well as funding working capital. Hedging arrangements have been put in place to fix the Company's interest costs.

Work continues on the possibility of raising debt without the benefit of the Government indemnity in the context of wider discussions on CP4.

Further details of funding arrangements are set out in the Notes to the financial statements.

Stakeholder relationships and transformation

Network Rail continues to build upon its improving relationships with its stakeholders. It recognises, however, the need for focus on further strengthening of this with rail users, its customers – the train operators, its wider stakeholders – government, funders, taxpayers, its suppliers and its staff. To achieve the goal of an affordable and sustainable railway requires these stakeholders' support and co-operation.

To deliver this Network Rail must have the right leadership and management and have people who share the same values and behaviours to create a world class organisation. The transformation programme launched in 2006 aimed at achieving this continues to progress well with action plans across the business at various stages of development and delivery. Significant resource is required throughout the Company to deliver the outputs sought from these plans.

Long-term planning

The challenges Network Rail faces require it to work with its industry partners to develop the right framework and culture in order to create and deliver the right whole-industry solutions which represent best value, most cost-effective and sustainable strategies for the industry. These plans must inform and take account of the high level specifications from Governments and the requirements of our other stakeholders.

In readiness for the 2008 Periodic Review, Network Rail worked closely with the Department for Transport and Transport

Scotland to support the development of their High Level Output Specifications. We are also continuing to develop appropriate whole industry strategies with the train operators to deliver the required outputs at an affordable price. Details of this were set out in Network Rail's Strategic Business Plan published in October 2007 and in the update published in April 2008.

Control Period 4 Determination

In October 2008 the Office of Rail Regulation (ORR) will make its determination for the funding settlement for Network Rail for the next Control Period (CP4). It has been Network Rail's objective to assist the ORR to reach a challenging but realistic view of its plans and to provide evidence to justify this view to help inform the ORR's review process which will lead to its determination.

In October 2007 Network Rail published its Strategic Business Plan (SBP) setting out what Network Rail plans to do in CP4 consistent with an overall industry strategy and a longer term view of how the industry should meet the challenges of the future. The SBP was based on extensive discussion with the Company's rail industry partners. It represented Network Rail's main submission to the ORR periodic review of our access charges for CP4. It responded formally to specifications of the outputs which Governments (in England & Wales and in Scotland) want to buy from the railway (the High Level Output Specifications (HLOS) and their corresponding Statements of Funds Available, or SOFAs).

At that time the Company recognised that there were aspects of its plans which required further development (such as performance plans and financing plans) and that further work was needed to enhance co-ordination with the rail industry partners to deliver Network Rail's plans for CP4 and to develop robust longer term plans for Control Period 5 (CP5) and beyond.

Following the publication of the SBP, the ORR published its initial assessment of the affordability of the Governments' output specifications. It concluded that there was a high likelihood that these specifications could be delivered within the funds they had committed to the railways for the next Control Period.

Since the SBP was published Network Rail has worked closely with train operators and suppliers to develop and improve its plans. There remain, however, challenges. The plans need to be deliverable on time, at an acceptable cost and without causing excessive disruption to passengers and freight users. Moreover Network Rail is being challenged to:

- deliver substantial improvements in efficiency on top of the progress achieved over the last few years
- reach levels of punctuality which have never been seen before with more people and improved journey times
- deliver several billion pounds of investment every year while continuing to operate an increasingly congested railway
- operate an increasingly seven-day railway to create additional industry revenue and better services to users
- become more flexible in meeting the aspirations of the Company's rail industry partners.

Building on the work undertaken since publication of the SBP, Network Rail published on 4 April an update to the SBP (SBP update) addressing the outstanding issues associated with the SBP. In particular, it sets out Network Rail's position in those areas which it has acknowledged required further work or it provides further justification and evidence in support of the projections in the SBP. The SBP update is not intended to provide a full refresh of the SBP. It should therefore be read in conjunction with that plan and the supporting material which was presented with it.

The SBP and supporting documents set out in considerable detail Network Rail's policies and strategies for delivering the HLOS outputs. The ORR's initial assessment welcomed progress in a number of areas including the ongoing development of the Infrastructure Cost Model (ICM) and the closer working with train operators in some areas. There were clearly a number of areas where Network Rail had not provided sufficient evidence to justify its proposed plans. Equally it is essential that Network Rail understands the basis of any adjustments which the ORR plans to make in its draft conclusions to be published in June 2008 so that Network Rail can understand the implications and how it might reprioritise its activities accordingly.

The main areas where Network Rail has done further work and updated its projections following the publication of the SBP are:

- the budget for 2008/09 – the last year of this Control Period
- changes in Network Rail's core maintenance and renewal volumes for CP4
- updating assessment of the cost of delivering the HLOS performance targets in England & Wales
- refinements to Network Rail's plans for delivering the HLOS capacity enhancements.

In order to build on the successes of the rail industry over recent years and to further develop improvements, the outcome of the current regulatory review needs to conclude with challenging but realistic targets for the next Control Period. Network Rail will then be able to focus on working with its rail industry partners to deliver its plans for CP4 whilst also developing sound and affordable plans for CP5 and beyond.

Performance indicators

The ORR sets certain regulatory financial and non-financial performance targets for Network Rail. The key performance indicators (KPIs) are summarised in the table on the right.

Safety

Steady progress has been made in most of the key safety performance indicators as shown on the right.

Train performance

There are two measures relating to train performance – Train Delay Minutes being the number of minutes of train delays attributable to Network Rail, and Public Performance Measure (PPM) being the percentage of trains arriving on time at their final destination.

In 2003 the ORR set a target for the Company to improve the reliability of the network by more than 30 per cent by 2008/09. Over the last four years, reliability has improved significantly and total delays caused by Network Rail in 2007/08 are around 9.5 million minutes and this is reflected in PPM which has improved to 89.9 per cent. It reflects a widely different performance between areas directly in Network Rail's control and the impact of external events. The

Performance indicators	Notes	2007/08	2006/07	2005/06
Safety				
Public Safety Index	1	0.303	0.581*	0.543**
Performance				
Train Delay Minutes (million mins.)	2	9.5	10.5	10.5
Public Performance Measure	3	89.9%	88.1%	86.4%
Asset stewardship				
Asset Stewardship Incentive Index***	4	0.63	0.72	0.80
Financial control				
Financial Efficiency Index***	5	78.1	82.2	85.1

- 1 The Public Safety Index figure for 2007/08 is based on a new calculation aligning Network Rail's classification of trespasser accidental fatalities and suspected suicides with the classification of Railway Safety Standards Board (RSSB). Figure for 2007/08 is not comparable, therefore, with those shown for 2006/07 and 2005/06.
- 2 Train Delay Minutes are the number of minutes of train delays attributable to Network Rail (rather than the train operating companies) as defined in the contractual performance regime with operators.
- 3 Public Performance Measure is the overall rail industry key performance indicator measuring punctuality and reliability of train performance. It shows the percentage of trains that arrive 'on time' at their final destination compared to the number of trains planned to run on a given day. 'On time' means arrival within 10 minutes of the planned destination time for long distance operators and within 5 minutes for London and south east or regional operators.
- 4 Asset Stewardship Incentive Index is an index proposed by the ORR in its December 2003 access charges review. The components of this index and weightings are: track geometry index (20 per cent), number of broken rails (15 per cent), Level 2 exceedences (15 per cent), total number of signalling failures (15 per cent), wrong side signalling failures – hazard rating 20 or above (15 per cent), structure and earthworks train speed restrictions (10 per cent), and traction power supply failures AC and DC (10 per cent).
- 5 Financial Efficiency Index is a measure of the efficiency of operations, maintenance, track renewals and other key central expenditure. Prior year figures have been indexed in line with current year to enable comparison.

* To 31 December 2007

** To 31 December 2006

*** A lower figure represents an improvement.

Safety indicators	2007/08	2006/07	2005/06
Workforce fatalities	2	–	4
Severe Category A SPADs*	19	19	98
Broken rails	181	192	317
Collisions at level crossings	8	12	15
Significant train accidents	27	31	24
Passenger accidental fatalities**	10	7	3

* SPAD = signal passed at danger. Figure for 2006/07 is based on a new calculation and therefore is not comparable with those shown for 2005/06. Current measurement is based on a 100 point scale.

** One of the passenger fatalities in 2006/07 was caused by a train accident. None of the passenger fatalities in 2005/06 were caused by train accidents.

PPM achieved, therefore, meets the target set by the ORR for 2008/09 a year early.

Asset stewardship

The Asset Stewardship Incentive Index is a basket of measures which are intended to capture the underlying condition of Network Rail's assets. In 2007/08 this index continued to be significantly better than the ORR target and even better than the more challenging targets set in

Network Rail's business plans and management incentive plans.

The targets for two elements of this index were revised in 2006/07. As a result of significant improvement in the number of level two exceedences and track geometry in 2006/07 and further opportunities to correct underlying causes of track geometry faults, these targets were made tougher for 2007/08 and the following year.

Financial efficiency

The Financial Efficiency Index (FEI) is a measure of how efficiently Network Rail spends on operations, maintenance and track renewals. As efficiency improves the Company should spend less to deliver the same outputs and therefore the FEI should reduce. To make the measure more meaningful over time the FEI was turned into an index with the outturn for 2003/04 being equal to 100.

The current measure covers 68 per cent of the total operating, maintenance and renewals expenditure. Work continues to further widen the FEI in the future.

Business performance

Network Rail believes that business performance improvement is dependent in part on the development of key skills and behaviours of employees. To improve these, investment is being made in a range of programmes.

To measure progress in behaviours an employee engagement survey has been developed. This survey is conducted each year, the most recent being in November 2007.

The results of this latest survey showed improvement in employee engagement against the previous results. Further improvement is now being sought with a programme of communication of the results of the survey together with training and action plans to increase employee engagement. The next survey is scheduled to be conducted in November 2008 with further surveys planned for subsequent years.

Environment

Network Rail's approach is to focus on the key environmental issues facing it as operator of the rail infrastructure but also the issues facing society as a whole – climate change, waste, biodiversity and land management. It is committed to the on-going improvement of the railway's existing environmental record.

Network Rail's response to the challenge of managing environmental risk includes improving the lineside environment with a policy of vegetation management that balances the responsibility to provide a safe and reliable railway whilst acknowledging the benefits of minimising the impact on the natural habitat. Its work with English Nature in this area continues.

Waste management is also important with schemes in place to improve responsible waste handling and recycling both by the Company and by its contractors. Climate change is also an ongoing focus with participation in research programmes organised by various specialist bodies. Likewise energy and water usage are subjects of ongoing programmes of reduction.

A framework within which environmental, societal and economic impacts are considered with a view to continuing to develop rail as a sustainable form of transport has been progressed.

Health and safety

The health and safety of the Company's employees, whilst working within the business, and the public, whilst travelling on the railway infrastructure, are of great importance to Network Rail. The Company's policies and procedures relating to health and safety at work recognise the requirements of current legislation and are kept under constant review with the aim of providing a safe working environment for all employees. Significant resource is committed to safety, health and environmental matters and Network Rail aspires to continuing improvement of its performance in these areas.

Previous incidents and recent regulatory penalties

The derailment which took place at Potters Bar in May 2002 is the subject of continuing HMRI investigations; the outcome is unknown at present. The derailment in Cumbria in February 2007 is also the subject of investigation; the outcome is unknown at present.

In July 2007 the ORR as economic regulator concluded that Network Rail Infrastructure Limited breached its network licence in relation to the planning and execution of the Portsmouth re-signalling scheme and imposed a penalty on the company of £2.4m. The ORR has also levied a penalty of £14m against Network Rail Infrastructure Limited for breach of the network licence resulting from network disruption over the Christmas 2007 period.

Corporate social responsibility

Network Rail is committed to carrying out its activities in a socially responsible manner in respect of customers,

stakeholders, employees and local communities. As part of its objective of operating in a transparent and accountable environment, a further report on these aspects within its business is due to be published in 2008.

Network Rail also has an environmental policy as detailed in its Corporate Responsibility Report 2006. This has been revised and details of this will be set out in the Corporate Responsibility Report 2008.

Code of business conduct

The Company has adopted a code of business conduct that is applicable to all employees.

Research and development

During the year the Company charged £1m to the Income statement (2006/07: £1m) on research and development. Other costs relating to significant development work have been capitalised in tangible fixed assets.

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

Directors

The Directors of the Company were appointed on the dates as shown in the table below.

Under the provisions of the Articles of Association of Network Rail all Directors, except the Special Director (if appointed – there being no Special Director at the

time of publication of this report), must retire by rotation, and may stand (together with any new Director appointed since the last general meeting) for re-election by the Members of that Company at least every three years. Save as shown in the table below there were no other changes to the Board during the year.

The biographical details of the Directors can be found on pages 22 and 23.

Directors' interests

The Directors have no interests in the Company.

Employees

Details of the number of employees and related costs are set out in Note 7 to the financial statements on page 52.

Network Rail recognises the role of its employees in enabling the Company to achieve its business objectives. This is reflected in the Board's commitment to equal opportunities and effective employee communications.

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

Current Directors	Position	Date of first appointment	Next due date for re-election
Ian McAllister	Chairman	22 March 2002	July 2009
Iain Coucher	Chief Executive	22 March 2002	July 2009
Peter Henderson	Group Infrastructure Director	1 October 2002	July 2010
Ron Henderson	Group Finance Director	12 August 2002	July 2008
David Bailey	Non-Executive Director	15 August 2002	July 2010
Ian Buchan	Non-Executive Director	5 February 2006	July 2009
Yvonne Constance	Non-Executive Director	1 May 2005	July 2008
Jim Cornell	Non-Executive Director	3 October 2002	July 2009
Michael Firth	Non-Executive Director	4 December 2004	July 2010
Christopher Green	Non-Executive Director	26 June 2005	July 2010
Steve Russell	Non-Executive Director	19 September 2007	July 2008

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

During the Business Briefings conducted in January 2008 around 7,000 employees were able to attend the geographically spread briefings at which the Company's safety and operational performance were discussed and employees had the opportunity to question the Executive Directors and Chairman on any aspect of the business that they chose to raise. To monitor progress Network Rail conducts an annual survey of employee engagement with an active follow-up programme to address practical issues.

There is also a strong belief by the Board of the Company in the importance of consultation on issues affecting the workforce. Frequent consultation and information sharing is conducted therefore at regular intervals through both national and local procedures with representatives from Network Rail and trades unions.

Our equal opportunities policy is communicated to employees. We are committed to offering our employees a fulfilling and challenging career in an environment free from discrimination, harassment, victimisation and bullying. Network Rail continues to work with trades unions in the area of equality of opportunity and development of policy to promote best practice within the business.

Employee review processes are in place to allow every individual manager to discuss key performance issues in a structured, fair and consistent way and to identify training and development needs.

Corporate structure and members

As a company limited by guarantee, the Company has no share capital and does not have shareholders, but instead has Members. The role of Members is similar to that of shareholders in a public limited company. In particular, Members of Network Rail have an important role in monitoring that Network Rail is managed in line with high standards of corporate governance. Members of the Company

have a liability to contribute the sum of £1 each in the event of the winding-up of the Company in circumstances where it cannot meet its debts in full.

Network Rail has two general classes of Member: Industry Members and Public Members. In addition, the Department for Transport is a Member of Network Rail. There are currently 108 Members in total.

Industry Members and Public Members have the same voting and other rights, subject to certain differences which are contained within Network Rail's Articles of Association. These differences relate, in particular, to the procedures for application for membership, appointment as Member and the duration of membership.

Under the terms of the Railways Act 2005 the Strategic Rail Authority was abolished and its responsibilities were divided principally between the Department for Transport and Network Rail, largely with effect from June 2005.

Department for Transport (DfT)

DfT's Rail Group was set up in the summer of 2005 following the passing of the Railways Act 2005. The Group combines the Department's overarching strategic and financial responsibilities for the railways with many of the functions formerly carried out by the Strategic Rail Authority.

Industry members

Any 'eligible industry stakeholder' (as defined below and opposite) may apply to be a Member of Network Rail and, subject to compliance with the application procedures described in the Membership policy, shall be an Industry Member. Eligible industry stakeholders are not eligible to apply for Public Membership. If there is more than one eligible industry stakeholder in any corporate group, then only one of those eligible industry stakeholders will be entitled to Industry Membership.

'Eligible industry stakeholders' comprise the following three categories:

- 1 any person (other than Network Rail or a subsidiary of Network Rail) who (a) is authorised by a licence to be the operator of railway assets pursuant to Section 8 of the Railways Act 1993 and (b) is operating such assets in Great Britain by virtue of such licence.

- 2 any person (other than Network Rail or a subsidiary of Network Rail or a person who is eligible under paragraph 1 above) who is a railway undertaking (as such term is defined in Council Directive 95/18/EC of 19 June 1995 (as amended)) who (a) is authorised by virtue of a licence issued by a Member State of the European Union to provide services for the transport of goods and/or passengers by rail and (b) is providing such services in Great Britain by virtue of such licence.
- 3 any person who is the bidder announced by or on behalf of the DfT as the preferred bidder for a franchise to provide services for the carriage of passengers by rail in Great Britain (provided that any such person shall cease to be eligible under this category upon ceasing to be such a preferred bidder (whether as a result of the franchise being granted or the termination of the bidding process or otherwise)).

Public Members

Public Members are organisations and individuals drawn from a cross-section of the community. The initial Public Members were appointed for three years by the Board, in November 2002, following a process of selection and recommendation by an independent Membership Selection Panel (MSP). This term of appointment was due to expire in the autumn of 2005. In April 2005 the MSP made recommendations to the Board on renewal of membership which were accepted whereby the majority of existing memberships were renewed for periods of one, two or three years.

In November 2006 one third of these renewed public memberships expired and 28 new Public Members were appointed at that time to replace these. Another third of the original Public Memberships expired in November 2007 and were replaced with 28 new Public Members. With effect from November 2008 the final third of the original Public Members will expire and a process for selection of new Public Members to replace these was launched in May 2008. New appointments are scheduled to take effect in November 2008.

Contributions for charitable and political purposes

During the year the Group donated £508,000 to charitable organisations (2006/07: £496,000). A further £285,000 (2006/07: £477,000) was used to sponsor charitable and community-related activities.

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

Under company law disclosure is required of particulars of any donations to any EU political organisation and EU political expenditure incurred. The definition of these types of donation is uncertain. On one strict interpretation the Group made payments during this year which may fall within the meaning of this type of donation. These payments form part of the work Network Rail does with community representatives such as elected representatives (Members of Parliament, Members of the Scottish Executive, Welsh Assembly and London Assembly, regional assemblies, local councils and others) as well as non-government organisations, pressure groups and campaigning organisations. This work includes meetings to discuss issues facing the Company and those using the rail infrastructure, both passengers and freight customers nationally and regionally. Opportunity is also taken to explain the Strategic Business Plan, operational performance and significant developments within the business. These are sometimes best achieved through the Group organising briefings and similar functions at which presentations are given or attendance takes place at party political conferences and events.

Creditors' payment policy

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

At 31 March 2008 the Group's creditor days compared with the value of suppliers' invoices received in the year was 44 days (2006/07: 51 days).

Auditors

At the next Annual General Meeting of Network Rail on 16 July 2008, a resolution will be proposed to reappoint Deloitte & Touche LLP as the Group's auditors and to authorise the Directors to fix their remuneration. Details of the fees earned by Deloitte & Touche LLP during the period, for both audit and non-audit work, are set out in Note 6 on page 52.

Pursuant to the Companies Act 1985 Section 234 ZA each of the Directors confirms that, so far as he or she is aware, there is no relevant audit information of which the Company's auditors are unaware and that he or she has taken all responsible steps in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

By order of the Board

Hazel Walker
Secretary
27 May 2008

Board of Directors



Ian McAllister CBE

Chairman (2, 4)*

Ian McAllister, 64, is the Company's Non-Executive Chairman having previously been Chairman and Managing Director of Ford Motor Company Limited. Ian is also Chairman of the Carbon Trust, a Director of the Energy Saving Trust, a Director of UCL Business plc and until recently Senior Independent Non-Executive Director of Scottish & Newcastle plc. He is Chairman of the Greater Essex Prosperity Forum. Ian is a member of the Institute of Chartered Accountants in England and Wales' Corporate Responsibility Advisory Group.

Ian Buchan

Non-Executive Director (2, 5)*

Ian Buchan, 61, joined the Board in 2006 after retiring as Chief Executive of National Express' trains division. He was previously Business Development Director at FirstGroup. Until earlier this year he was a director of Manchester School of Flying. Originally an economics graduate, Ian has also been a school governor.

Iain Coucher

Chief Executive (3, 5, 6)*

Iain Coucher, 46, took over as Chief Executive from John Armit in August 2007. Previously, since Network Rail acquired Railtrack plc in October 2002, he was Deputy Chief Executive. Prior to that he was Chief Executive of Tube Lines, which followed working for EDS for 16 years. His career has included experience in the transportation sector, particularly with London Underground. He was seconded to the TranSys consortium between 1996 and 1998 as its Chief Executive and led the development of the Underground's smartcard ticketing system. Iain is an Engineering graduate from Imperial College, London and also has an MBA.

Yvonne Constance OBE, JP

Non-Executive Director (1, 2)*

Yvonne Constance, 65, joined the Board in 2005 having previously been Chairman of the National Electricity Consumers' Council between 1995 and 1999, a Non-Executive Director of Innogy plc from 2000 to 2002 and a Non-Executive Director of St Mary's Hospital NHS Trust. Until its cessation in 2005 she was also a member of the Greater London Magistrates' Courts' Authority, as well as being a Justice of the Peace since 1976 and, in the 1980s, practised as a barrister.

Michael Firth

Non-Executive Director (1, 2, 6)*

Michael Firth, 65, joined the Board in 2004 having previously been Head of Corporate Banking at HSBC Bank plc until his retirement in September 2002. He is also a Non-Executive Director of Communisis plc and Gartmore European Investment Trust plc. He was previously a Non-Executive Director of Somerfield plc and First Technology PLC. Michael is an Associate of the Chartered Institute of Bankers.

Ron Henderson

Group Finance Director (3, 6)*

Ron Henderson, 62, was formerly Group Finance Director of BICC plc, Finance Director of Balfour Beatty, and most recently Chief Executive of Tuberaill, one of the bidders for the London Underground public private partnership. Prior to this, Ron, a Scottish Chartered Accountant, was at Halliburton, Brown and Root and earlier with Arthur Andersen.

Christopher Green

Non-Executive Director (2, 5)*

Christopher Green, 64, joined the Board in 2005 following his retirement as Chairman of Virgin Rail Group. Chris has over 40 years of railway experience, having joined British Rail upon leaving university. He held various management positions including Managing Director of Network SouthEast and Intercity. He was Chief Executive of Virgin Trains from 1999 to 2004. Chris was also Chief Executive of English Heritage, a non-executive director of Eurotunnel and past Chairman of the Railway Forum. He is a Trustee of the Liverpool Royal Philharmonic Orchestra.

Peter Henderson

Group Infrastructure Director (3)*

Peter Henderson, 54, has responsibility for Engineering, Maintenance, Projects and Logistics. He has over 25 years' rail experience. Starting with the construction of the Tyne and Wear Metro, he then spent 16 years with the Hong Kong Mass Transit Railway Corporation as Head of Major Projects. He returned to the UK in 2000 to work for Bechtel where he was Projects and Engineering Director for Rail.



Jim Cornell

Non-Executive Director (2, 4, 5)*
Jim Cornell, 68, joined British Rail (BR) in 1959 as a student civil engineer before taking up various positions in BR including General Manager of Scotrail, Director of Civil Engineering and latterly Group Managing Director of British Rail Infrastructure Services between 1993 and 1996. He is also Executive Director of the Railway Heritage Trust. He was appointed the Senior Independent Non-Executive Director of Network Rail in January 2006.

Steve Russell

Non-Executive Director (2)*
Steve Russell, 63, joined the Board in September 2007. Previously he was Chief Executive of Boots Group PLC between 2000 and 2003, working there since he started his first job at the company in 1967. He currently holds several non-executive directorships including Barclays PLC – where he is chairman of the audit committee and a member of the board risk committee and Business Control Systems Group. He is also a trustee of St John's Ambulance and Tommy's, the baby charity.

* Numbers against Directors' names indicate the committees of the Board on which each of them serves as follows:

- 1 Audit Committee
- 2 Remuneration Committee
- 3 Executive Management Group
- 4 Nominations Committee
- 5 Safety, Health and Environment Committee
- 6 Treasury Committee

David Bailey OBE

Non-Executive Director (1, 2, 4, 5)*
David Bailey, 68, joined the Board in August 2002. David has a procurement and logistics management background. He was formerly Commercial Director for London Transport, having previously held various director-level roles within London Underground. David is Chairman of Atlas-GOSS Limited and two charities, Home-Start North East Hampshire and Rushmoor Children and Young People's Partnership.

Directors' remuneration report

The following report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002 (the Regulations) and the Financial Reporting Council's Combined Code issued in June 2006.

The Remuneration Committee

Given the importance of remuneration and incentivisation to the business the Remuneration Committee comprises all of the Company's Non-Executive Directors including the Chairman of Network Rail. The Committee members are:

Jim Cornell – Chairman of the Committee
David Bailey
Ian Buchan
Yvonne Constance
Michael Firth
Christopher Green
Ian McAllister
Steve Russell*

* Joined 19 September 2007

The Group Company Secretary is the secretary to the Committee.

The Committee is required under its terms of reference to meet at least once a year and during the year 2007/08 it met six times.

The Committee is responsible for determining all matters concerning the remuneration and incentivisation of the Executive Directors of the Company. This includes making decisions in respect of the framework of the Executive Directors' remuneration and its cost as well as determining, on behalf of the Board, specific remuneration packages for each of the Executive Directors. It decides the remuneration package for the Chairman without the Chairman being present. It also decides upon the form and content of the Executive Directors' Management Incentive Plan (MIP) for each financial year (within the terms of the Incentive Policy). Additionally the Committee determines the framework of certain senior executive employees' remuneration as well as the form and content of their MIP.

The full terms of reference of the Committee are available on request and can be found on the Network Rail website www.networkrail.co.uk.

During the year the Committee's activities included:

- determining the incentive awards to be paid pursuant to the MIP 2006/07
- finalising the MIP 2008/09
- reviewing the benchmarking of basic salaries.

The Committee commissioned Hewitt New Bridge Street Consultants LLP to provide independent expert advice on the management incentive schemes and remuneration generally. Hewitt New Bridge Street does not provide other services to Network Rail.

During 2007/08 Watson Wyatt Limited advised the Company in respect of pension related matters included in the remuneration policies.

The Chief Executive and the Human Resources Director also attend Remuneration Committee meetings by invitation and assist the Committee in its considerations but do not participate in discussions or decisions relating to their own remuneration. The Human Resources Director is responsible for employees within Network Rail and is not a Board Director nor is he appointed by the Committee.

Directors' remuneration policy

Network Rail Infrastructure Limited has a network licence condition requirement to have a MIP for its Executive Directors and senior executives and for that plan to be cascaded throughout the Company. Under this condition Network Rail is required, when formulating its MIP, to have particular regard to:

- securing the operation and maintenance, renewal and replacement, improvement, enhancement and development of the network especially operational performance, asset serviceability and condition, efficiency, economy and safety
- infringement by Network Rail of any access contracts and safety factors
- achievement of the licence requirement of dealing with dependent persons with due efficiency and economy and in a timely manner and

compliance with Network Rail's Code of Practice for dealings with dependent persons

- the extent to which Network Rail is subject to orders and to statements by the Office of Rail Regulation (ORR) on non-compliance with the licence.

The ORR may also specify other objectives in connection with the MIP.

Taking into account these regulatory requirements the Committee has formulated Network Rail's remuneration strategy to attract and retain competent individuals and to create the potential to reward outstanding performance at a competitive market rate based on individual contribution and the overall success of Network Rail in meeting the objectives of the Business Plan.

These principles are reflected in the terms of the Management Incentive Policy which can be modified only with the consent of the ORR. Under this policy the objectives and principles are to:

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

These are structured within a total remuneration approach, defined as the sum of base salary, incentives and benefits. The use of variable pay through

the availability of incentives to form a significant part of total remuneration is intended to ensure that each individual's reward is clearly linked to the successful delivery of Company objectives.

Account is taken of information from internal and independent sources on the remuneration for comparable positions in relevant regulated and unregulated companies. The strategy for Executive Directors' pay is for base salaries broadly to reflect the relevant market median, for benefits such as car allowances and medical insurance to reflect market practice, for pensions to reflect the rail industry practice and for total direct compensation (i.e. base salary and incentives) to be broadly competitive in the appropriate marketplace, provided always that performance justifies the amount. This strategy is consistent with the Company's belief that performance should determine a sizeable proportion of the total remuneration package for Executive Directors.

Through the following means the Company sought transparency in respect of the principles upon which remuneration of the Directors of the Company has been set:

- publication in 2007 of a statement detailing the contents of the Executive Directors' MIP 2007/08 (pursuant to the terms of Network Rail's network licence)
- publication in May 2008 of a statement detailing the contents of the Executive Directors' MIP 2008/09 (pursuant to the terms of Network Rail's network licence).

Executive Directors' reward package

The current package for Executive Directors under their service agreements comprises the following elements:

Base salary

This is a fixed cash sum payable over 13 periods during the financial year. The Committee reviews salaries annually as part of the total reward package recognising market levels and personal contribution. The aim is to ensure that salaries are competitively set at broadly median levels in relation to similar roles in appropriate regulated companies and companies within the FTSE.

Current salaries for the Executive Directors, following the most recent salary review effective from 1 July 2007 are:

Executive Directors	Annual base salary as at 31 March 2008 £
Iain Coucher*	585,000
Peter Henderson	420,000
Ron Henderson	400,000

* Due to appointment as Chief Executive on 1 August 2007 salary review was made effective on that date and reflects promotion to this position.

Incentive arrangements

The purpose of the MIP is to place additional emphasis on the delivery of the objectives of the Business Plan.

MIP 2007/08 – annual incentive

As detailed in last year's Annual Report, the annual bonus for 2007/08 was to be calculated measuring actual Company performance against the three equally-weighted targets set in the MIP 2007/08. These were Reliability Index, Asset Stewardship Incentive Index (ASII) and Financial Efficiency Index (FEI).

The structure of the MIP for 2007/08 incorporated for the first time a taper principle. This allows significant performance to be recognised against a background of continued year on year stretch performance charges. The specific targets and taper trigger points are decided by the Remuneration Committee, taking into account Regulatory Targets.

For each measure a taper level, target level and maximum level of achievement was set, with the maximum level representing at least the achievement of the 2008/09 Business Plan a year early. Achievement between the target level and maximum is calculated on a 'straight line' basis.

The following level of bonuses became payable under the terms of the MIP 2007/08:

- in respect of Reliability Index, the taper target was 1.320, target figure was 1.375 with a maximum target of 1.421. The actual result was 1.353, producing a payment of 10 per cent of salary for this element

- in respect of ASII the target was 0.700 with a maximum target of 0.680. The actual result was 0.634, producing a payment of 33.33 per cent of salary for this element
- in respect of FEI the taper target was 79.6, target level of achievement was 77.9 with a maximum target of 73.0. The actual result was 78.1 producing a payment of 14.7 per cent of salary for this element.

The resultant total potential award was 58 per cent of basic salary. In accordance with the terms of the MIP, the Committee then considered whether to use its discretion by reducing the overall bonus award for the Executive Directors having regard to Network Rail's safety performance, the extent to which the key objectives of the Business Plan over the performance period have been achieved and the requirements of Network Rail's network licence.

In exercising its discretion the Remuneration Committee recognises the incentive scheme as an important variable element of the Executive Directors' (and senior managers') remuneration. To be effective, reward under the scheme must be based on clear, visible and demonstrable measures in order to act successfully as a reliable incentive mechanism. The overriding discretion held by the Committee must be used, therefore, on an equally consistent and proportionate basis with significant emphasis being placed on the three measurable criteria set out in the MIP. These have been carefully designed to balance the competing aspects of delivering a successful rail infrastructure performance. The use of the discretion must not undermine the confidence of the Executive Directors in the achievability of incentive awards.

It is still important, however, that the Committee does consider each year whether there are other factors which should influence the decision on whether the full award is payable under the scheme for the year in question. To assist in its review of performance of the Executive Directors, the Remuneration Committee considers a wide range of performance indicators beyond the three set measurements contained within the MIP. These include:

- safety performance – including workforce fatalities and accident

frequency rate, passenger accident fatalities, the safety index, significant train incidents and Category A SPADs

- compliance with regulatory matters including regulatory recovery plans, compliance with licence conditions, whether there have been any breaches of the network licence (whether or not this has been followed by a performance order) and compliance with any other regulatory objectives imposed
- breach of major contracts
- operational performance impact of possession overruns
- additional financial performance including investment spend profiles, level of net debt of the Company
- significant environmental incidents.

The views of the ORR are also carefully considered and in particular such views expressed by the ORR to the Committee Chairman which this year covered the ORR's views on reliability, efficiency, asset stewardship, safety performance and breach of licence.

Industry relationships and end-user reputation are also very important to Network Rail. Recognising the disruption caused to Network Rail customers and passengers, the Christmas 2007 overruns were a major focus of the Committee this year.

It concluded that the inconvenience and disruption are reflected in the outturn of the reliability performance measure of the MIP. The FEI measure was also adversely affected by the ORR's fine levied. In combination the awards payable under these two measures (which comprise two thirds of the bonus measures) were automatically impacted by the overruns reducing them by 11 per cent.

This reduction represents an important validation of the robustness of the MIP performance measurement structure as having relevant and effective mechanisms reflecting the significance of performance failures to TOCs, FOCs, passengers and freight customers.

Notwithstanding this the Committee believes that the adverse reputational impact to the Company of the overruns has been significant. Consistent with the Company's commitment to continuous focus on operational excellence, therefore, the Committee concluded that

in addition to the resulting automatic reductions in incentive awards it would exercise its discretion to reduce the awards further. The awards in total were reduced by the Committee, therefore, by a further 10 per cent over and above the initial reduction under the terms of the MIP.

Details of the resulting bonus payments awarded to each Director are detailed on page 30.

MIP 2008/09 – annual incentive

Participants under the MIP 2008/09 will be eligible to receive bonuses based again on demanding business performance measures and targets. The MIP 2008/09 uses key performance indicators (KPIs) based upon those contained in the Strategic Business Plan 2007 but in certain respects more stretching.

The business and individual performance measures relate directly to the objectives set out by the ORR in paragraph 3 of Condition 28 of the network licence of Network Rail Infrastructure Limited (including the achievement of the purpose of Condition 7 (stewardship) and Condition 25 (code of practice on dealing with dependent persons)), compliance with other licence conditions and with conditions of access agreements.

Potential L-TIP awards (audited)

Director	Performance period						
	1 April 2006 to 31 March 2009	1 April 2007 to 31 March 2010			1 April 2008 to 31 March 2011		
	£	£	2007/08	2008/09	2008/09	2009/10	2010/11
Iain Coucher	214,650	305,581	a	b	a	b	c
Peter Henderson	160,153	219,391	a	b	a	b	c
Ron Henderson	160,153	208,944	a	b	a	b	c
Total	534,956	733,916	a	b	a	b	c

Notes

For performance period 1 April 2007 to 31 March 2010 and 1 April 2008 to 31 March 2011 the L-TIP will be calculated on an average of three annual award payments subject to performance conditions.

To assist in describing this calculation the above table has been annotated with a, b and c to represent the appropriate unknown annual payments.

2007/10: The maximum L-TIP payment for the performance period 1 April 2007 to 31 March 2010 is equal to the average of the annual payments received for the years 2007/08, 2008/09 and 2009/10. For Iain Coucher the calculation to set the maximum award will be:

$$\text{L-TIP maximum} = (£305,581 + a + b) / 3$$

2008/11: The maximum L-TIP payment for the performance period 1 April 2008 to 31 March 2011 is equal to the average of the annual payments received for the years 2008/09, 2009/10 and 2010/11. For Iain Coucher the calculation to set the maximum award will be:

$$\text{L-TIP maximum} = (a + b + c) / 3$$

These maximum sums will only be paid if the performance measures outlined on page 26 are met in full.

Business performance measures

The amount payable to Executive Directors will be calculated by reference to performance against the same output measures to those used in the 2007/08 MIP.

Reliability (weight one-third) – this is the index established to measure improvements in train performance, comprising of separate elements for passenger reliability and freight reliability weighted according to their respective traffic volumes. It comprises both Train Delay Minutes and PPM (weighted two thirds/one-third). For Train Delay Minutes this is expressed as an index per 100 train kilometres, to ensure that the impact of the volume of trains is correctly reflected.

Financial Efficiency Index (weight one-third) – this is a measure of the efficiency of operating, maintenance and renewal expenditure, normalised to take account of changes in the volume of work required. The coverage of the FEI is 68 per cent of total operating, maintenance and renewals expenditure.

Asset Stewardship Incentive Index (weight one-third) – this is an index proposed by the ORR in its December 2003 Access Charges Review. The components of this index and weightings are: track geometry index (20 per cent),

number of broken rails (15 per cent), Level 2 exceedences (15 per cent), total number of signalling failures (15 per cent), wrong side signalling failures – hazard rating 20 or above (15 per cent), structure and earthworks train speed restrictions (10 per cent), and traction power supply failures AC and DC (10 per cent).

Each of the above performance measures stands alone and is calculated independently. The total potential incentive award payable is then the sum of the outcomes of each measure.

The structure of the MIP scheme for 2008/09 incorporates the taper principle detailed above. This allows significant performance to be recognised against a background of continued year on year stretch performance charges. The specific targets and taper trigger points are decided by the Remuneration Committee, taking into account Regulatory Targets.

Payments under each of the three measures can only be made if performance meets or exceeds the trigger performance as determined by the Remuneration Committee in accordance with the taper principle. If target levels are achieved payments are calculated for above-target performance on a straight line basis up to maximum target level; the maximum incentive could be earned by achieving a level of performance at least equal to delivering one year early the 2009/10 performance on each measure as contained in the Strategic Business Plan 2007.

The Committee may exercise its discretion and reduce the amounts payable if, over the year, the overall business performance of Network Rail, including the level of safety performance and net debt, is deemed unsatisfactory.

The potential annual incentive entitlement if all three measures achieve target level is 50 per cent. The maximum possible entitlement is 100 per cent of salary, achievable only if all three measures hit maximum performance, by achieving a level of performance equal to or better than the 2009/10 performance described in the Strategic Business Plan 2007.

Personal performance measures

There are no individual performance measures set for the Executive Directors. The Committee continues to believe that collective accountability of the Directors necessitates a focus on collective performance incentives without individual performance measures. Other senior executives do have individual performance measures in addition to the business performance measures.

Long-term incentive (L-TIP)

Under the terms of the Management Incentive Policy there is a requirement to have a long-term incentive element within the MIP.

As Network Rail Limited is a company limited by guarantee it is not possible to use traditional long-term incentives due to the absence of shares as the reward method. The L-TIP is based, therefore, on a deferred additional cash award in which awards are made after each three-year period triggered by relevant long-term improvement in business performance targets. The Remuneration Committee has designed this to incentivise the organisation to work together as a team and with external parties throughout the industry over the long term to achieve the key business objectives of the Company.

At the 2007 Annual General Meeting of Network Rail its members approved the proposal by the Committee that the long-term incentive for each of the three years (starting 1 April 2008) to be calculated on the basis of the average of the awards made in each year of the three-year performance period 2008/09 to 2010/11.

The third performance period for the long-term incentive ended on 31 March 2008 and payments under that L-TIP have been calculated, based on the two targets for the scheme.

L-TIP for three-year period 1 April 2005 to 31 March 2008

Public Performance

Maximum Target	Minimum Target	Actual
88.7%	87.7%	89.9%

ORR cost reduction targets

Maximum Target	Minimum Target	Actual
£3,385m	£2,708m	£3,188m

Consequently payments were made at a level of 85 per cent to participants in this long-term plan, based on a maximum amount equivalent to the annual incentive earned in 2004/05 (as described in previous years' remuneration reports).

L-TIP for three years to 31 March 2008

Name	Amount earned
John Armitt*	£178,339
Iain Coucher	£204,709
Peter Henderson	£152,704
Ron Henderson	£152,704

* John Armitt retired from the Company on 31 July 2007.

The maximum potential value of the long-term incentives receivable by each Executive Director at the end of the respective performance periods of the other three-year periods is as shown in the table on page 27.

Performance measures

The two performance measures are:

Public performance up to 31 March 2006 the Public Performance Measure was the most appropriate measure of network performance for inclusion in this long-term incentive, reflecting delays attributable both to Network Rail and the train operating companies. This measure is the percentage of passenger trains arriving on time over each twelve-month period as published in 'National Rail Trends'. 'On time' is defined as running as planned and arriving less than five minutes late at final destination or less than ten minutes late for inter-city operators.

With effect from 1 April 2006, it was decided, following consultation with the passenger and freight train operators, to introduce a modified target as the base of the measure for public performance. This new measure is the 'Public Performance Target', which also includes delays to freight trains, measured on a similar basis to passenger delays. Passenger and freight delays are therefore both included in this measure, weighted according to the number of train kilometres for each category of traffic. The target level of achievement for full payment to be made under this measure is a Public Performance Target (PPT) at the level included in the relevant Business Plan.

For the period from 1 April 2007 to 31 March 2010, the PPT target has yet to be confirmed, at the time of publication of this report, as this is subject to discussions with the ORR regarding Control Period 4.

Cost reduction this measure reflects the cumulative cost reductions made in the three-year period. For full payment under the long-term incentive the target is achievement of a level related to the levels contained in the Business Plan 2006. No award under the long-term incentive will be payable unless at least 80 per cent of the cumulative savings set by the ORR are achieved.

If these targets are achieved in full, significant improvement to the rail network will have been delivered. The two measures are free standing and equally weighted. The Committee continues to believe that these two measures provide an appropriately challenging framework for the long-term incentive.

Regulatory MIP statement

As required under the network licence of Network Rail Infrastructure Limited, a statement will be published in May 2008 detailing the contents of the Executive Directors' MIP 2008/09.

Pensions

Executive Directors are entitled to pensions based on salary and length of service with a maximum pension of two-thirds of final base salary. Details are set out on page 31.

Directors' service terms

Executive Directors

The Executive Directors of the Company are also the Executive Directors of Network Rail Infrastructure Limited. Their contractual service agreements are with that company. No other contractual provisions or remuneration arrangements exist in relation to their directorships of the Company or any other company within the Network Rail Group.

At the time of drawing up the service agreements the Committee took into consideration the UK Listing Authority's corporate governance code and the recommendations contained within the joint statement of the Association of British Insurers and the National Association of Pension Funds published in December 2002 on best practice on executive contracts and severance.

These were applied as far as practicable and appropriate having regard to the nature of the business and the corporate structure of the Company and then current practice. With the retirement of John Armit in July 2007 and Iain Coucher's appointment to the role of Chief Executive at that time, the opportunity was taken to review Iain Coucher's service agreement against the then best practice and again so far as practicable and appropriate this has been adopted.

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

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

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

Executive Directors	Effective date of contract
Iain Coucher	1 August 2007*
Peter Henderson	3 October 2002
Ron Henderson	3 October 2002

*Being a new service agreement upon his appointment as Chief Executive, and having a previous service agreement as Deputy Chief Executive with an effective date of 3 October 2002.

Non-Executive Directors

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

Non-Executive Directors	Effective date of original contract
Ian McAllister	3 October 2002
David Bailey*	15 August 2002
Ian Buchan	5 February 2006
Yvonne Constance	1 May 2005
Jim Cornell**	3 October 2002
Michael Firth	4 December 2004
Christopher Green	26 June 2005
Steve Russell	19 September 2007

* David Bailey's appointment in 2002 was as Special Director; upon conversion of his appointment a new letter of appointment was issued in 2005.

** Jim Cornell had previously an appointment letter dated 14 December 2001.

External appointments

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

None of the Executive Directors currently holds a Non-Executive Director position with a listed company.

Non-Executive Directors' remuneration

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

Non-Executive Directors do not receive any benefits from the Company other than a fee together with their reasonable expenses for attending meetings of the Board and other meetings and events.

Current annual fees for the Non-Executive Directors are:

Non-Executive Directors	Fee £
David Bailey	42,000
Ian Buchan	42,000
Yvonne Constance	42,000
Jim Cornell*	63,000
Michael Firth**	57,000
Christopher Green	42,000
Ian McAllister	250,000
Steve Russell***	42,000

* Includes additional fees paid for his chairmanship of Board committees and membership of Membership Selection Panel.

** Includes additional fees paid for his chairmanship of Board committees.

***With effect from 19 September 2007 being the date of his appointment.

With effect from January 2005, in view of the additional responsibilities and time

commitment placed upon the chairmen of Board committees, and in line with the recommendations of the Higgs Report and good corporate governance practice, it was decided that additional fees would be paid to a Non-Executive Director who chairs any of the following Board committees:

Safety Health & Environment Committee
Audit Committee
Remuneration Committee
Treasury Committee

With the exception of the fee for the Chairman (which is determined by the Remuneration Committee), the fees of the Non-Executive Directors are agreed by the Executive Directors of the Board. These fees are designed to recognise the significant responsibilities of Non-Executive Directors and to attract individuals with the necessary high quality experience and ability to make an important contribution to the Company's business.

Disclosure of Directors' remuneration for 2007/08

Name	Notes	Salaries and fees £000	Bonuses Annual £000	L-TIP payments £000	Supple- mentary/ Company pension contributions/ AVC payments by the Company £000	Benefits (including pension allowances and life cover) £000	2007/08 Total £000
John Armit	1	195	101	178	58	6	538
David Bailey		42					42
Rob den Besten	2	11					11
Ian Buchan		42					42
Yvonne Constance		42					42
Jim Cornell	3	63					63
Iain Coucher		539	306	205	169	25	1,244
Michael Firth	4	57					57
Christopher Green		42					42
Peter Henderson		399	219	153	131	15	917
Ron Henderson		385	209	153	–	126	873
Charles Hoppe	5	13					13
Ian McAllister		250					250
Steve Russell	6	21					21

Notes

1 Up to 31 July 2007 when he retired.

2 Up to 30 June 2007 when he retired.

3 Includes additional fees paid for his chairmanship of Board committees and membership of Membership Selection Panel.

4 Includes additional fees paid for his chairmanship of Board committees.

5 Up to 18 July 2007 when he retired.

6 From 19 September 2007 when he joined the Board.

Directors' remuneration comparison: 2007/08 against 2006/07

Current Directors	Notes	2007/08 Total £000	2006/07 Total £000
David Bailey		42	40
Ian Buchan		42	40
Yvonne Constance		42	40
Jim Cornell		63	60
Iain Coucher		1,244	823
Michael Firth		57	53
Christopher Green		42	40
Peter Henderson		917	602
Ron Henderson		873	589
Ian McAllister		250	236
Steve Russell	1	21	–
Past Directors			
John Armit	2	538	903
Rob den Besten	3	11	40
Charles Hoppe	4	13	40
Total		4,155	3,506

Notes

- 1 Joined 19 September 2007.
- 2 Retired 31 July 2007.
- 3 Retired 30 June 2007.
- 4 Retired 19 July 2007.

Core pension benefits

	Gross increase in accrued RPS pension £ (A)	Increase in accrued RPS pension net of inflation £ (B)	Total accrued RPS pension at 31 March 2008 £ (C)	Transfer value of accrued RPS pension at 31 March 2007 £ (D)	Transfer value of accrued RPS pension at 31 March 2008 £ (E)	Total change in transfer value during period £ (F)	Value of net increase in accrual over period £ (G)
John Armit*	999	903	10,569	192,657	217,262	20,880	14,833
Iain Coucher	2,194	1,885	10,307	102,443	105,697	(7,863)	8,220
Peter Henderson	2,194	1,885	10,307	143,490	170,059	15,452	19,994
Ron Henderson	2,206	1,886	10,631	169,641	218,565	37,807	27,652

*John Armit retired from the Company on 31 July 2007.

Notes

- 1 Pension accruals shown are the amounts which would be paid annually on retirement (or earlier leaving) based on service to the end of the year.
- 2 Transfer values as at 31 March 2007 (D) and 31 March 2008 (E) have been calculated in accordance with version 8.1 of guidance note GN11 issued by the actuarial profession.
- 3 The change in the transfer value (F) includes the effects of fluctuations in the transfer value due to factors beyond the control of the Company and Directors, such as stock market movements. It is calculated after deducting the Director's contribution.
- 4 The value of net increase (G) represents the incremental value to the Director of their service during the year, calculated on the assumption that service terminated at the year end. It is based on the accrued pension increase (B) after deducting the Director's contribution.

Directors' emoluments (audited)

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

The total amount of Directors' emoluments for services provided solely to the Company during the year was £4,155,000 (2006/07: £3,506,000).

Directors' pensions (audited)

The table on page 31 shows the pension entitlement from the Network Rail section of the Railways Pension Scheme (RPS), and additional defined contribution arrangements of each Executive Director of the Company during the year ended 31 March 2008, together with the increases in those benefits during the year, calculated using the accrued benefit basis.

The increases in RPS benefits during the year represent the amount of the extra annual pension entitlement earned resulting from additional length of service or changes in salary.

The increase in accrued approved benefit during the year is shown in the table on page 31. Values are shown before (column A) and after (column B) the exclusion of the effect of inflation. All benefit values shown exclude the effect of any additional voluntary contributions made by the Director.

Executive Directors participate in the RPS and benefit accrues at a rate of one-sixtieth for each year of membership. They contribute to the RPS at the same rate as other members of the Network Rail section. In addition, some Directors are entitled to additional pension benefits that are provided through the Network Rail Defined Contribution Pension Scheme.

The following sections describe the pension benefits received by Executive Directors in 2007/08:

In normal circumstances the earliest age at which the Executive Directors are entitled to receive their defined benefit pension without actuarial reduction is age 60. However, the Directors can retire early on the same terms and conditions that apply to other members of the Network Rail section of the RPS from the age of 50. The actuarial reduction factors that apply under the RPS are a two per

Additional pension benefits

	Company contributions to additional pension provision whilst a Director during the year £ (H)	Company payments to additional pension provision in respect of prior year £ (I)	Matching Company additional voluntary contributions whilst a Director during the year £ (J)
Current Directors			
Iain Coucher	168,638	133,008	–
Peter Henderson	131,164	97,821	–
Ron Henderson	–	–	–
Past Director			
John Armitt	56,137	149,637	1,627

Notes

- 1 The current Directors were Directors for the whole year.
- 2 The past Director was Director to 31 July 2007.
- 3 Ron Henderson elected to receive an equivalent additional allowance in lieu of additional pension contributions. This payment is included in the benefit figure reported on page 30.
- 4 The contributions in respect of previous years are not included in column (H).
- 5 None of the Non-Executive Directors is a member of the Network Rail section of the RPS and Non-Executive Directors have no other pension entitlements from the Company.

cent per annum reduction between the ages of 60 and 55 and a three per cent per annum reduction for ages below 55. In keeping with other members of the scheme, the right to take early retirement benefits is at the option of the individual, subject only to having left the Company's employment.

In addition to members' benefits, dependants' pensions are payable after the death of the member, in line with those payable to all members of the RPS. These are at the rate of half the pension the member would have received at age 60 on death in service or half the member's basic pension on death in retirement or after leaving service. Basic pension is pension before commutation for cash and excluding any benefits arising from Additional Voluntary Contributions. In addition, the RPS pays pensions to surviving children. Where two children survive, a pension additional to the dependant's pension is paid at three-eighths of the pension the member would have received at age 60, or three-eighths of the member's basic pension after leaving service or in retirement. Children's pensions are paid to the age of 18 or a later age, at the discretion of the Network Rail Section Pensions Committee, if the child is in full time education or disabled. The RPS provides guaranteed increases to all pensions in payment and deferment in line with the retail prices index.

Additional pension benefits

As described on the previous page, some Directors are entitled to additional pension benefits in which case the Director could choose the extent to which the gross payment was made to the pension arrangement, or taken as cash. Future contributions are at a pre-determined level, and the amount has been notified to each Director. The contributions made during the year together, where appropriate, with contributions in respect of benefits accrued prior to the year under review are shown in the table opposite.

The RPS also operates a matching additional voluntary contribution facility, whereby voluntary contributions paid by members are matched by equivalent payments from the Company, up to certain limits. These matching arrangements were frozen for all members of the Network Rail section of the RPS at the levels applicable on 6 November 2003, and this limit was applied to Directors as to other members. Matching payments made in 2007/08 are also shown in the table opposite.

Performance graph

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

Directors' interests

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

On behalf of the Remuneration Committee



Jim Cornell
Chairman, Remuneration Committee
27 May 2008

Corporate governance report

Corporate governance principles

The Board considers that good corporate governance is central to achieving the Company's objectives and to the principle of safeguarding stakeholders' interests in the rail infrastructure. The Company is committed to high standards of business behaviour and has an established governance framework which comprises an organisational structure, internal control systems and business conduct policies. These form the framework for effective decision-making and delivery of the quality rail infrastructure this country needs.

It is also a condition of Network Rail Infrastructure Limited's network licence that, from 3 October 2002, it complies with the governance principles contained in the code annexed to the UK Listing Authority's listing rules (as amended with effect on 1 June 2006) (the Code). The Code includes a requirement for companies to make statements on corporate governance in their annual reports.

Having reviewed the requirements of the Code, the Directors consider that Network Rail has complied throughout the financial year ended 31 March 2008 with the provisions set out in Section 1 of the Code. This Corporate Governance Report, coupled with the Directors' Remuneration Report, explains how the Company has applied the governance principles set out in the Code. Details of the Company's internal controls are set out on pages 40 to 41.

Board of Directors

The Board is responsible for the overall management of the Group and in particular for governing the strategic direction of the business, supervising its operational management and providing leadership within a governance framework which it oversees. This responsibility extends to taking overall responsibility for financial performance, internal controls and risk management of the Company.

The information on pages 22 and 23 shows that at the date of this report the Company is led and controlled by a board currently comprising three Executive Directors and eight Non-Executive Directors. The Board believes its composition possesses wide

experience both within the rail industry and generally as well as the necessary range of qualities, skills and experience to lead the Company effectively.

Directors are appointed by the Board and are also the Directors of Network Rail Infrastructure Limited. Under the provisions of the Articles of Association of the Company all Directors (other than the Special Director – see below) must retire by rotation, and may stand (together with any new Director appointed since the last general meeting) for re-election by the Members of the Company at least once every three years. One new Non-Executive Director has been appointed since the AGM in 2007 – Steve Russell joined the Board in September 2007.

The names of the Directors due to stand for re-election at Network Rail's Annual General Meeting (AGM) in July 2008 are set out on page 19 of the Directors' Report and further information will be given in the documents accompanying the Notice of the AGM to be sent to members of Network Rail Limited.

The Board's responsibilities

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

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

Matters delegated to Executive Management Group or below are also subject to financial limits above which Board approval is required.

The roles of the Chairman and Chief Executive

The responsibilities of the non-executive Chairman include leading the Board and ensuring its effectiveness. He sets the agenda for the meetings of the Board and, with the assistance of the Group

Company Secretary, arranges for the Directors to receive timely, accurate and clear information before Board meetings and updates on issues arising between meetings. The Chief Executive is responsible for leading and managing the business on a day-to-day basis within the authorities delegated by the Board and is accountable to the Board for the financial and operational performance of the Group.

The roles of the Chairman and the Chief Executive are distinct and separate and their responsibilities are clearly established being set out in writing and having been agreed by the Board. The Chairman is responsible for the workings and leadership of the Board.

Non-Executive Directors and their independence

The Non-Executive Directors combine broad business and commercial experience (both from the rail industry and from other industry sectors) to enable them to challenge and contribute constructively to the development of the strategy of the Group. They also scrutinise the performance of management in meeting agreed goals and objectives and monitor operational performance of the business.

The current Senior Independent Director is Jim Cornell. He is available to Members as an additional point of contact to the Chairman and the Chief Executive.

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

1 Jim Cornell was, until 1996, a (non-Board) Director of British Rail. He currently receives a pension from the Network Rail section of the Railways Pension Scheme. He is also Executive Director of the Railway Heritage Trust. The Board considers, however, that as a Non-Executive Director of Network Rail, Jim Cornell is independent as he was not an employee or Executive Director of Railtrack PLC. Furthermore the corporate structures of Network Rail Infrastructure Limited and this Company, being a not-for-dividend company, eliminate any potential or perceived conflicts between his being

a Non-Executive Director of the Company and receiving a pension from the Network Rail section of the Railway Pension Scheme.

Jim Cornell, having held various senior roles within British Rail before retiring on the creation of Railtrack PLC, is a highly experienced and respected railwayman who contributes considerable knowledge to the Group. This enables him to challenge constructively and effectively operational matters within the Group as well as participating in the full range of responsibilities of a Non-Executive Director.

- 2 David Bailey was previously the Special Director appointed to the Board of Network Rail Limited by the Strategic Rail Authority (SRA) pursuant to its then rights under the Articles of Association of that company. Following the changes under the Railways Act 2005 with the responsibilities of the SRA passing principally to the Department for Transport (DfT), the DfT has not exercised its right to appoint a Special Director.

The Board considered that David Bailey makes a valuable contribution to the Company in his Non-Executive Director role. His wide ranging commercial experience has enabled him to provide additional perspective on issues and the Company wished to retain him as it moved into its new roles. At Network Rail's AGM in 2005 his appointment as a Non-Executive Director was approved.

- 3 Christopher Green currently receives a pension from the Network Rail section of the Railway Pension Scheme. The Board considers, however, that as Non-Executive Director of Network Rail he is independent as he was not an employee of Railtrack PLC.

None of the Non-Executive Directors are members of more than three committees of the Board except David Bailey, who is a member of the Nominations, Remuneration, Audit and Safety, Health and Environment Committees. Upon the conversion of his appointment in June 2005 to Non-Executive Director, he has continued to be a member of these committees due

to the valuable contribution he is able to make to each of these.

Board meetings

The Board met formally nine times in 2007/08. There is a schedule of items to be brought to the Board throughout the year and a format for each meeting is prepared and agreed which enables the Directors to review corporate strategy regularly together with the operations and results of the business units within the Group and to discharge their other duties. Each meeting includes reports on the safety, health and environmental performance of the Group as well as on operational and financial performance against the Business Plan and targets. There are also periodical risk management reviews of the key strategic risks to the Group and the Board receives regular presentations from senior management on both current issues as well as future plans.

Upon acquisition of the business in 2002 the demands on the Board's management skills in the early days focused on the need for significant overview of immediate day to day management. As the Company has developed the demands on the Board have moved to high level management of the overall strategic development of the business for the future.

Following the annual review of the workings of the Board and its committees in February 2007, therefore, the Board concluded that the number of scheduled meetings and the format of its meetings would be adjusted accordingly to reflect the maturing state of Network Rail's business. With effect from January 2008 the Board adopted a timetable of eight scheduled Board meetings each year with the format of these meetings enabling even greater focus on and opportunity to debate future strategic issues facing the rail industry in addition to reviewing current performance of the business.

Annually the Chairman holds at least one meeting with the Non-Executive Directors without the Executive Directors present to discuss the performance of the Company under the executive leadership. Further, periodically a meeting of the Non-Executive Directors chaired by the Senior Independent Director is held without the Chairman present.

A table detailing the individual Directors' attendance at each of the Board and committee meetings is set out on page 39.

Organisational structure

The Board has established an organisational structure which is designed to allow for effective and efficient decision-making across the business. The Board has delegated authority to the committees described below on specific matters, which are set out in their terms of reference. These authorities are reviewed regularly. The terms of reference of the Safety, Health and Environment, Audit, Remuneration, Nominations and Treasury Committees are published on the Company's website and copies are available on request. Minutes of all committee meetings are made available to Directors.

The composition of each committee is designed to maximise the range of skills and experience of Board members with the aim of not placing undue reliance on any one individual. Each committee may request any information from the executive management necessary to discharge its functions and may, if it considers necessary, seek independent advice and counsel.

There are five standing Board committees with defined terms of reference as follows:

The Safety, Health and Environment Committee

Composition This Committee comprises three Non-Executive Directors and the Chief Executive and is chaired by Jim Cornell. The Director, Safety & Compliance usually attends the meetings by invitation.

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

Process The Committee conducts its responsibilities through a series of scheduled meetings with forward agendas set each year to meet the responsibilities of the Committee. The Committee chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting. Its work in fulfilling its responsibilities includes:

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

In addition to this Committee, and reflecting the recommendations in the Cullen Report, two executive committees have been set up, dealing with strategic and tactical safety matters. Moreover, the Board receives a report on safety, health and environment matters at each of its scheduled meetings.

Activities in 2007/08 During the year ended 31 March 2008, this Committee met six times and its principal activities included review of the following:

- safety, health and environment performance reports of the Company
- significant internal safety related incident reports
- selected key operational safety risks
- progress with implementation of the Safety in the Line assessment project
- the status of safety, health and environment related activities and responsibilities of the principal functions within the Company

- analysis of emerging trends from recent safety assurance activity and significant accidents and incidents
- key findings in annual regulatory safety reports by the Railway Accident Investigation Board, Rail Safety and Standards Board and the Office of Rail Regulation
- the status of inquiries' recommendations
- the rail strategic safety plan for 2008
- the Company's safety, health and environment risk management
- the Committee's annual performance evaluation.

The Audit Committee

Composition This Committee is comprised of three Non-Executive Directors and is chaired by Michael Firth who has a financial background and experience at chairing a listed company's audit committee. The Chief Executive, the Group Finance Director, the Group Financial Controller and the Head of Internal Audit normally attend meetings of the Committee. Two partners from the external auditors also attend each of the Audit Committee's meetings and periodically meet with the Committee without executive management present.

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

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

- reviewing the internal control framework and the register of financial and non-financial risks (so far as these are not reviewed by other Board committees such as the Safety, Health and Environment Committee)
- monitoring financial reporting practices including considering accounting

- policies and practices and compliance with accounting standards
- reviewing significant accounting estimates and judgements
- reviewing interim and annual financial statements before publication
- considering and making recommendations to the Board in relation to the appointment, re-appointment and removal of the external auditors following its assessment of their independence and objectivity (including the safeguards that are in place to maintain such independence) and their terms of engagement and remuneration
- reviewing the internal and external audit process including the scope of its planned audit and subsequently its audit findings
- reviewing the policy and procedure whereby employees can raise, in confidence, concerns about possible improprieties.

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

Activities in 2007/08 During the year ended 31 March 2008, this Committee met four times and its principal activities included consideration of the following:

- interim and full year financial results
- the 2007/08 internal audit plan and resources required
- quarterly internal control reports from the internal audit function
- the effectiveness of the internal audit function
- the effectiveness of the external audit process
- the independence and objectivity of the external auditors
- the 2007/08 external audit plan and associated audit fees
- the Company's internal control framework including the risk management process and progress on the management of the key risks identified by the Company
- the status of employee concerns reporting/whistle-blowing

- the Committee's annual performance evaluation.

External Auditors Independence and objectivity of the external auditors is of great importance to the Committee. A policy is in place to assist this whereby employment of the external auditors on work for Network Rail other than audit services or tax consulting services is prohibited without prior approval by the Audit Committee. A new lead partner is appointed every five years, with other key audit principals rotating every seven years.

The Committee has responsibility for advising the Board on the appointment, re-appointment and the remuneration of the external auditors. Deloitte & Touche LLP (Deloitte) has been the Company's external auditors since 2002 (and prior to that to Railtrack plc since 1996). Each year the Audit Committee conducts an assessment of the effectiveness of Deloitte and periodically conducts a more detailed review. In 2008 the Committee conducted again this more detailed review, having previously done so in 2005.

A lengthy questionnaire was completed by the external auditors detailing their procedures, training and audit processes as well as how independence and objectivity is maintained. Consultation within the Company as to the performance of the external auditors was also carried out. As a result of the assessment, the Audit Committee has recommended to the Board that at the AGM in July 2008 it proposes the re-appointment of Deloitte as auditors until the conclusion of the AGM in 2009.

The Remuneration Committee

Composition This Committee comprises all of the Company's Non-Executive Directors and is chaired by Jim Cornell. It determines appropriate levels of Directors' and senior executives' remuneration including their incentive scheme. The Committee's report is contained in pages 24 to 33.

The Nominations Committee

Composition This Committee is chaired by Ian McAllister as the Chairman of the Board and comprises two further Non-Executive Directors.

Role The role of the Committee includes:

- reviewing regularly the size, structure and composition of the Board (including use of suitable periodic performance evaluation processes) and making recommendations to the Board on any adjustments that may be deemed necessary and feasible (including on matters such as succession planning)
- evaluating the balance of skills, knowledge and experience of the Board
- identifying and nominating candidates for appointment as director for approval by the Board
- satisfying itself that appropriate succession plans and processes are in place for the appointments to the Board and to senior management positions.

Process The Committee conducts its responsibilities through meetings held as appropriate. The Committee chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting. Between meetings, the Committee chairman discusses matters of succession and recruitment with the other members of the Committee on an ad hoc basis as required.

Activities in 2007/08 During the financial year 2007/08 the Nominations Committee has met once to consider performance evaluation of the Board, its committees and Directors, succession planning, organisational structure and possible candidates for appointment as Non-Executive Directors of the Company. This process included consideration of the experience and skills sought for the role and commissioning Egon Zehnder International to conduct various searches for suitable candidates.

As a result of this process Steve Russell was recommended by the Committee to the Board for appointment as a Non-Executive Director – such appointment was approved by the Board with effect from September 2007. In accordance with the Articles of the Company Steve Russell will be seeking election at the Annual General Meeting in July 2008.

More generally for succession purposes the Company reviews internal executive skills regularly including through the use of a 'talent pool' that uses assessment

testing and other data to identify suitable candidates for succession opportunities. Individuals identified with senior management potential also attend focused leadership development training at the Company's own centre which provides courses in collaboration with Warwick Business School (a part of Warwick University).

The Treasury Committee

Composition This Committee comprises three directors, with Michael Firth as chairman. The Director of Funding and other senior funding managers attend the meetings.

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

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

Activities in 2007/08 During the year ended 31 March 2008, the Committee met three times and its principal activities included consideration or review of the following in relation to the various funding arrangements for the Group:

- the debt issuance programme
- the current and forecast debt ratios and valuation of the existing hedging portfolio
- the interest rate hedging controls and accounting
- the cash investment strategy, including fund allocation strategy and investment risk mitigation
- renewal of the Company's clearing bank contract
- risk capital options
- funding and treasury risk management
- treasury policy and activities
- debt maturity profile
- options relating to the Company's financing structure for Control Period 4
- investor relations activity
- the Committee's annual performance evaluation.

Executive Management Group

Composition At executive level in the Company there has previously been the Executive Committee chaired by the Chief Executive, and comprising all the Executive Directors and a number of senior executives.

Following review of this Committee's responsibilities and activities in 2007 and with effect from October 2007 its name was changed to the Executive Management Group and its composition was revised with the inclusion of a number of other senior managers being Functional Directors within the whole business. The Group is chaired by the Chief Executive.

Role This Group manages the functions of the business and implements the operational and financial objectives within limits set by the Board.

Process The Group conducts its responsibilities through a series of scheduled meetings.

Activities in 2007/08 During the year ended 31 March 2008, the Executive Committee/Executive Management Group met eleven times and its principal activities included approval (within its delegated authority) and review of operational issues and activities of the Company including:

- the operational, financial and safety, health and environment performance of the Company
- reports into significant rail incidents
- the Company's budget for 2008/09
- investment projects and contract awards
- progress reports on significant projects and programmes
- route utilisation strategies
- the regulatory periodic review process including the development of the Strategic Business Plan and its update
- the Company's risk management
- development of corporate key performance indicators
- the Company's industrial relations activities
- HR policies and strategic plans
- the status and activities of the World Class Transformation Programme
- the Company's response to regulatory consultation documents.

Other management meetings

Additionally there is a defined structure of other executive steering groups and

panels with terms of responsibilities focusing on specified aspects of the operational needs of the business with prescribed levels of authority.

Meetings during 2007/08

The table opposite identifies the number of meetings held between 1 April 2007 and 31 March 2008 of the Board, the five main Board committees, the Executive Committee (to the creation of the Executive Management Group in October 2007) and the Executive Management Group (from its creation in October 2007) and the attendance record of individual Directors.

There may be occasions when circumstances arise which prevent a Director from attending a meeting in person. It is usual practice in these circumstances for the Director concerned to review the papers and convey any views to the chairman of the meeting in advance.

Information about the Directors' remuneration is given in the Directors' Remuneration Report on pages 24 to 33 of this Report and details of how the Board reviews financial and operational controls and risk management generally are shown on pages 40 to 41.

Board effectiveness Induction and development

There is a comprehensive programme of induction for new Directors aimed at ensuring that they are fully conversant with their responsibilities as a Director and with the business of Network Rail. This includes provision of a manual of key documents and background information relating to the Company and the industry, guidance on Board procedures and corporate governance matters. Thorough briefings on their responsibilities are given and site visits and one-to-one meetings with each of the Executive Directors, key senior managers and key stakeholders are also held.

Directors are then encouraged to update their skills, knowledge and familiarity with the Group through their on-going participation at Board and committee meetings, and through regular occasions for them to meet senior managers, other employees and Members as well as through site visits to operational locations.

Ongoing professional development is provided to Directors each year. During the past 12 months the Directors received briefings on relevant issues including new developments relating to company law and other new legislation. Additional personal development is also available to all Directors. Directors are encouraged to attend externally organised seminars.

Board evaluation review

The Nominations Committee is charged by the Board to review annually the performance of the Board, its principal committees and individual Directors. This is achieved through a formal process whereby guidelines to areas of focus have been drawn up with the assistance of external consultants. These guidelines form the basis for the evaluation process. Each review focuses on matters such as company strategy, performance, delegation and accountability, corporate responsibility, succession, relationships with stakeholders, Board and committee composition, Board communication and the contribution and effectiveness of individual Directors. The findings of the review of the Board are considered and discussed by the Board. The review of individual Directors is considered by the Chairman of the Board and each Director receives personal feedback.

The policy adopted by the Nominations Committee is for external assistance also to be provided in conducting the review on a bi-annual basis. In the interim year the review is to be conducted internally by the Group Company Secretary. Separate meetings are held with each of the Directors.

In line with this policy, consultants, Egon Zehnder International, were again engaged to assist with the process for 2007/08. This latest review, conducted in February 2008, has led the Board to conclude that it and its committees continue to operate effectively and they are meeting the needs of the Company. Opportunities were also identified for development of enhancements to such effectiveness which are to be explored.

The Nominations Committee has also concluded that each Director is continuing to contribute to the overall effectiveness and success of the Company and that each of the Directors who are proposed for election or re-election at the AGM in July 2008

	Board	Safety, Health and Environment Committee	Nominations Committee	Remuneration Committee	Audit Committee	Executive Committee/ Executive Management Group	Treasury Committee
Number of meetings held	9	6	1	6	4	11	3
Directors							
John Armitt ¹	4	2	–	3 ⁺	–	4	2
David Bailey	9	6	1	6	4	–	–
Rob den Besten ²	3	–	–	3	1	–	–
Ian Buchan	9	3 ³	–	6	–	–	–
Yvonne Constance	9	–	–	6	4	–	–
Jim Cornell	9	6	1	6	–	–	–
Iain Coucher	9	5	–	3 ³⁺⁴	4 ⁴	10	2
Michael Firth	9	–	–	6	4	–	3
Christopher Green	9	5	–	6	–	–	–
Peter Henderson	9	–	–	–	–	11	–
Ron Henderson	9	–	–	–	4 ⁺	11	3
Charles Hoppe ⁵	3	2	–	2	–	–	–
Ian McAllister	9	–	1	6	–	–	–
Steve Russell ⁶	5	–	–	2	–	–	–

1 Until his retirement on 31 July 2007.

2 Until his retirement on 30 June 2007.

3 From his appointment to this Committee on 20 September 2007.

4 From/in readiness for his appointment as Chief Executive on 1 August 2007.

5 Until his retirement on 19 July 2007.

6 From his appointment on 19 September 2007.

+ As attendee.

continue to demonstrate the necessary commitment to the Company and to be fully effective members of the Board.

Company Secretary

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

removal of the Group Company Secretary is a matter for the Board as a whole.

Advice

There is a procedure whereby Directors, wishing to do so in furtherance of their duties, may take independent professional advice at Network Rail's expense.

Relations with Members and stakeholders

The Board of Network Rail is extremely committed to, and recognises the importance of, developing and maintaining an ongoing relationship based on regular communication and dialogue with its wide range of stakeholders.

Members

A variety of forms of contact with Members of Network Rail is used to help them hold the Board to account for

the performance of the Group and to help the Members be aware of and understand developments within the business. Opportunities are also arranged on a frequent basis to enable discussion by the Members to take place. The various forms of communication include:

- publication of full Annual Reports and Accounts
- publication of Interim and Preliminary Results
- Annual General Meeting and other general meetings of Network Rail as required
- supply of key press releases, business documents and other material
- copies of the Company's staff magazine
- regular meetings with Directors and senior Network Rail staff
- periodical local briefings and site visits;
- regular presentations on key issues
- copies of documents published by other bodies e.g. the ORR's quarterly monitor on Network Rail, key ORR consultation documents and other reports
- the services of a staff member dedicated to responding to enquiries and issues raised by Members
- information contained on the Company's website – www.networkrail.co.uk

In addition, following the network disruption experienced at the end of the Christmas 2007 public holiday, a special meeting was arranged at which the Directors reported to Members on their initial findings into the causes of the disruption and the actions the Company would be taking to avoid repetition of such disruption.

Network Rail's website is updated frequently with announcements, the Strategic Business Plan and the Strategic Business Plan update, the Annual Report and Accounts, the Management Incentive Plan statement and other documents and information. Members of Network Rail also have their own internet site.

Members have the opportunity to meet the Board both before and after the formal general meetings as well as to ask questions at the AGM (including by submission of written questions in advance). Before the AGM Members are also encouraged to request areas of

the business on which they would like presentations.

Members are also invited to a meeting facilitated by Network Rail at which the ORR, the rail industry's regulating body, presents the ORR's views on the current performance of Network Rail against its regulatory obligations.

In connection with Network Rail's AGM, the level of proxy votes is disclosed (including the details of the votes for, against and the abstentions for each resolution). The chairmen of the Board committees are available at the AGM to answer questions in relation to their committee's area of responsibility. In addition and in line with best practice, the Notice of the AGM and any related papers were sent out to Members to arrive at least 20 business days before the date of the meeting to ensure that Members have sufficient time in which to consider the items of business.

The next AGM will be held on 16 July 2008.

Other stakeholders

The Company also recognises the importance of good relationships with its wider stakeholder base especially its customers – the passenger and freight train operators, its suppliers, funders and its own employees. Emphasis is placed, therefore, on developing existing relationships as well as expanding the breadth of relationships. This includes the Chief Executive, other Executive Directors and Functional Directors having regular meetings with representatives of the ORR (as both economic and safety regulator), passenger and freight train operators and other rail stakeholders.

Independent relationship surveys are conducted regularly with each of the Company's customers (the train operators), passengers and freight end users, suppliers and its employees (using an employee engagement survey – see pages 19 and 20 of the Directors' report for more detail).

Corporate Responsibility

Corporate responsibility is also an important aspect of the role of Network Rail which the Company takes seriously. A report on its corporate responsibility priorities and activities during the year will again be published in 2008.

There is also a Corporate Responsibility Committee chaired by the Chief Executive which has responsibility for co-ordinating the strategy for the Company's achievement of its responsibilities in this area.

Internal control

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

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

The risk management process is now well established and forms an integral part of the Network Rail planning and review activity. Risk types actively managed include safety, reputation, performance and financial risks. Risk management processes incorporate the following:

- the identification of risks to the achievement of business objectives by all business units and major projects together with the likelihood/impact analysis and the development of mitigation actions to manage risks at the desired levels
- a Company Standard for risk management to provide consistency of approach across business units
- a self certification process which requires function heads to confirm that risk management processes are being complied with and that their risk data is accurate and complete
- the capture and recording of risks, risk scoring and action plans in a company wide risk management system

- the regular reporting and review of business unit and major project risks by the Executive Directors at monthly business reviews.

During the year the risk management system has been further strengthened through the following initiatives:

- the peer review of causal risk maps which provide an overview of strategic risk interaction across functions and support regular review of the risk profile by the Audit Committee and the Board
- the introduction of risk assessment into investment planning processes using the corporate risk matrix scoring system.

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

- regular structured reviews of all business units and major projects by the Executive Directors assessing progress against objectives with action being taken as required
- a framework of delegated authority and accountability based on a templated organisation structure
- board approval of business strategies and objectives, together with plans, annual budgets and targets
- the monthly reporting of financial results, safety and other operational KPIs
- procedures for planning, approving and managing all investment expenditure including the use of the Guide to Railway Investment Projects (GRIP) specifying the requirement and timings for approvals sought by the Investment Panel and, where above its delegated financial level, by the Executive Management Group and the Board
- suite of Financial Regulations governing the accounting and stewardship of all financial transactions; during 2007/08 the Financial Regulations were fully revised and re-issued
- centralised treasury operations acting within defined limits and overseen by the Treasury Committee
- monthly accounting reviews to scrutinise financial data and increase confidence in the integrity of the accounts

- continuous monitoring by the Legal Services function within the Company, of claims and litigation issues affecting the Group
- governance of all business change initiatives through the Executive Management Group
- commitment to continuous improvement in levels of competence via leadership, competency and training programmes
- insurance assessment and appropriate cover for residual risks
- business continuity and disaster recovery plans for key operational assets, corporate offices and IT applications.

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

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

Internal Audit works closely with the External Auditors and other assurance providers to encourage co-ordination of audit plans and optimisation of audit resources. The Head of Internal Audit and the External Audit Partner meet on a regular basis.

The Company also has an established process by which staff may, in confidence, raise concerns about possible improprieties. Matters arising from the investigation of fraud are reported to the Audit Committee by the

Head of Internal Audit. There is an ongoing programme undertaken by Internal Audit to raise awareness of fraud issues with management.

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

Going concern

The Directors are satisfied that the Company has adequate resources to continue to operate for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the accounts.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements. The Directors are required to prepare financial statements for the Group in accordance with International Financial Reporting Standards (IFRSs) and have also elected to prepare financial statements for the Company in accordance with IFRS. Company law requires the Directors to prepare such financial statements in accordance with International Financial Reporting Standards, the Companies Act 1985 and 2006 and Article 4 of the IAS Regulation.

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

be achieved by compliance with all International Financial Reporting Standards.

Directors are also required to:

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

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and Group, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a Directors' Report and the Directors' Remuneration Report which comply with the requirements of the Companies Act 1985 and 2006.

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

Independent auditors' report to the Members of Network Rail Limited

We have audited the Group and individual Company financial statements (the 'financial statements') of Network Rail Limited for the year ended 31 March 2008, which comprise the Consolidated Income statement, the consolidated and individual Company Statements of recognised income and expenses, the consolidated and individual Company Balance sheets, the consolidated and individual Company Cash flow statements and the related Notes 1 to 32. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' remuneration report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report, the Directors' remuneration report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted for use in the European Union are set out in the Statement of Directors' responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' report is consistent with the financial statements. The information given in the Directors' report includes that specific information presented in the Group Finance Director's review that is cross-referred from the Directors' report. In addition, we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

The Directors have asked us to report to you if, in our opinion, the Company has not complied with any of the four Directors' remuneration disclosure requirements specified for our review as if the Listing Rules of the Financial Services Authority applied. These comprise the amount of each element in the remuneration package and information on share options, details of long term incentive schemes, and money purchase and defined benefit schemes. We give a statement, to the extent possible, of details of any non-compliance.

The Directors have asked us to review whether the Corporate governance report on page 34 reflects the Company's compliance with the nine provisions of the 2006 Combined Code specified for our review as if the Listing Rules of the Financial Services Authority applied, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

Basis of audit opinion

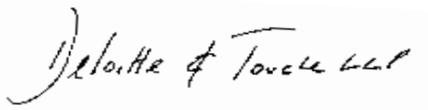
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' remuneration report to be audited.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 March 2008 and of its profit for the year then ended
- the individual company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the individual company's affairs as at 31 March 2008
- the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation
- the information given in the Directors' report is consistent with the financial statements.



Deloitte & Touche LLP
Chartered Accountants and Registered
Auditors
London, United Kingdom
27 May 2008

Income statement

for the year ended 31 March 2008

	Notes	2008 Group £m	2007 Group £m
Revenue	3	5,960	5,795
Net operating costs	5	(3,536)	(3,505)
Operating profit		2,424	2,290
Revaluation movements and profits on disposal of properties		34	102
Total profit from operations	6	2,458	2,392
Investment revenue	8	111	51
Other gains and losses	9	33	(25)
Finance costs	10	(1,014)	(944)
Profit before tax		1,588	1,474
Tax	11	(405)	(442)
Profit for the year		1,183	1,032

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

Under section 230 of the Company's Act 1985 the Group has elected to take the exemption with regard to disclosing the Company Income statement. The Company's net profit for the year was £nil (2007: £nil).

Statements of recognised income and expense

for the year ended 31 March 2008

	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
Recognised income and expense in the year				
Gains on revaluation of the railway network	403	73	–	–
Gains/(losses) on cash flow hedges	370	(183)	–	–
Exchange differences on retranslation of foreign currency debt taken to hedging reserve	(393)	351	–	–
	(23)	168	–	–
Actuarial (losses)/gains on defined benefit pension schemes	(133)	122	–	–
Tax on items taken directly to equity	(69)	(106)	–	–
Impact of change in corporation tax rate	132	–	–	–
Net income recognised directly in equity	310	257	–	–
Transfers				
Transferred to the Income statement on cash flow hedges	4	4	–	–
Tax on items transferred from equity	(1)	(1)	–	–
	3	3	–	–
Profit for the year	1,183	1,032	–	–
Total recognised income and expense for the year	1,496	1,292	–	–

Balance sheets

at 31 March 2008

	Notes	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
Assets					
Non-current assets					
Intangible assets	12	74	75	–	–
Property, plant and equipment – the railway network	13	31,443	28,304	–	–
Investment property	14	949	948	–	–
Derivative financial instruments	22	98	41	–	–
Finance lease receivables	18	12	16	–	–
Total non-current financial assets		110	57	–	–
		32,576	29,384	–	–
Current assets					
Inventories	17	64	49	–	–
Finance lease receivables	18	3	3	–	–
Trade and other receivables	19	684	630	–	–
Derivative financial instruments	22	307	1	–	–
Held-to-maturity investments	16	8	–	–	–
Available-for-sale financial assets	16	47	–	–	–
Cash and cash equivalents	27	543	193	–	–
		1,656	876	–	–
Total assets		34,232	30,260	–	–
Current liabilities					
Trade and other payables	20	(2,384)	(2,210)	–	–
Bank loans and overdrafts	21	(5,082)	(2,867)	–	–
Derivative financial instruments	22	(69)	(105)	–	–
Short-term provisions	23	(12)	(15)	–	–
		(7,547)	(5,197)	–	–
Net current liabilities		(5,891)	(4,321)	–	–
Non-current liabilities					
Bank loans	21	(15,267)	(15,731)	–	–
Derivative financial instruments	22	(60)	(199)	–	–
Other payables	20	(1,663)	(1,374)	–	–
Retirement benefit obligation	31	(370)	(248)	–	–
Long-term provisions	23	–	(18)	–	–
Deferred tax liabilities	24	(2,765)	(2,428)	–	–
Obligations under finance leases	25	(9)	(10)	–	–
		(20,134)	(20,008)	–	–
Total liabilities		(27,681)	(25,205)	–	–
Net assets		6,551	5,055	–	–
Equity					
Revaluation reserve	26	3,870	3,606	–	–
Other reserve	26	249	242	–	–
Hedging reserve	26	(72)	(57)	–	–
Retained earnings	26	2,504	1,264	–	–
Total equity		6,551	5,055	–	–

The financial statements were approved by the Board of Directors and authorised for issue on 27 May 2008.

They were signed on its behalf by:

Iain Coucher Director

Ron Henderson Director

Cash flow statements

for the year ended 31 March 2008

	Note	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
Net cash generated from operating activities	27	2,434	2,428	–	–
Investing activities					
Interest received		90	71	–	–
Purchases of property, plant and equipment – the railway network		(3,544)	(3,256)	–	–
Proceeds on disposal of investment property		63	51	–	–
Capital grants received		328	169	–	–
Capital element of finance leases' receipts		3	3	–	–
(Purchase)/sale of financial investments		(53)	161	–	–
Net cash used in investing activities		(3,113)	(2,801)	–	–
Financing activities					
Repayments of borrowings		(4,414)	(9,900)	–	–
Repayments of obligations under finance leases		(1)	–	–	–
New loans raised		5,444	10,435	–	–
Net cash generated from financing activities		1,029	535	–	–
Net increase in cash and cash equivalents		350	162	–	–
Cash and cash equivalents at beginning of the year		193	31	–	–
Cash and cash equivalents at end of the year		543	193	–	–

Notes to the financial statements for the year ended 31 March 2008

1 General information

Network Rail Limited is a company incorporated in Great Britain and registered in England and Wales under the Companies Act 1985.

The Company registration number is 04402220.

The Company's registered office is situated at 40 Melton Street, London NW1 2EE.

The Company's principal activities are detailed in the Directors' report on pages 14 to 21.

Details of the Group's business activities, key events and changes during the year and likely future developments are contained in the Chairman's statement, the Chief Executive's review and the Group Finance Director's review. These financial statements should also be read in conjunction with the Corporate governance report and the Directors' remuneration report.

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 EU IAS regulation.

The financial statements have been prepared on the historical cost basis, except for the revaluation of the railway network to the lower of its same state replacement cost and value in use and the revaluation of investment properties, financial assets and liabilities measured at fair value through profit and loss (FVTPL) and derivative financial instruments to fair value.

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

Adoption of forthcoming standards

In the current year, the Group has adopted IFRS 7 *Financial Instruments: Disclosures* which is effective for annual reporting periods beginning on or after 1 January 2007, and the related amendment to IAS 1 *Presentation of Financial Statements*. The impact of the adoption of IFRS 7 and the changes to IAS 1 has been to expand the disclosures provided in these financial statements regarding the Group's financial instruments and management of capital (see Note 30). Five interpretations issued by the International Financial Reporting committee are effective for the current period. These are IFRIC 7 *Applying the Restatement Approach under IAS 29; Financial Reporting in Hyperinflationary Economies*; IFRIC 8 *Scope of IFRS 2*; IFRIC 9 *Reassessment of Embedded Derivatives*; IFRIC 10 *Interim Financial Reporting and Impairment*; IFRIC 11 *IFRS 2 – Group and Treasury Share Transactions*.

At the date of authorisation of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but yet to come into effect:

Amendments to IAS 1

IAS 23 (Revised) *Borrowing Costs*

IFRS 3 (Revised) *Business Combinations*

IFRS 8 *Operating Segments*

IFRIC 12 *Service Concession Arrangements*

IFRIC 13 *Customer Loyalty Programmes*

IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

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

Basis of consolidation

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

Revenue recognition

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

Supplements to the access charges and bonuses receivable from, less penalties payable to, customers are included in revenue. Additional contract amounts and bonuses payable to, less penalties receivable from, suppliers and the Office of Rail Regulation are included in operating expenditure.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which 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.

2 Significant accounting policies continued

Grants

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

Leasing

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

The Group as lessor

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

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

The Group as lessee

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

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

Foreign currencies

Monetary assets and liabilities expressed in foreign currencies are translated into sterling at rates of exchange prevailing at the Balance sheet date. Individual transactions denominated in foreign currencies are translated into sterling at the exchange rates prevailing on the dates payment takes place. Gains and losses arising on retranslation are, with the exception of items that form part of a designated cash flow hedge relationship, 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

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

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

Operating profit

Operating profit is stated before investment income, finance costs, other gains and losses and revaluation gains 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 scheme, the cost of providing benefits is determined using the Projected Unit Credit Method, with full actuarial valuations being carried out at least every three years and updates to these valuations carried out in intervening years.

The Group's share of the actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the Income statement and presented in the Statement of recognised income and expense (see Note 31).

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

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

2 Significant accounting policies continued

Tax

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

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

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

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

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

Deferred tax is charged or credited in the Income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Property, plant and equipment – the railway network

The railway network is valued at depreciated replacement cost. This is calculated at the lower of its same state replacement cost and its value in use. The value in use is based on a discounted future cash flow that assesses the value to the business of the net income stream of the railway network.

The railway network is depreciated on a straight-line basis over its estimated remaining weighted average useful economic life. The estimated remaining weighted average useful economic life of the network is currently 25 years (2007: 25 years). The remaining weighted average useful economic lives are estimated annually, with external verification of the valuation and asset lives carried out where required.

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 arising from changes in the fair value of investment property are included in the Income statement for the period in which they arise.

Research and development

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

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

Intangible fixed assets

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

Inventories

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

Financial instruments

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

Trade receivables

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

2 Significant accounting policies continued

Investments

Investments are recognised and derecognised on a trade date where a purchase or sale of an investment is under contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at cost, including transaction costs.

Investments are classified as held for trading, held-to-maturity or available-for-sale, and are measured at subsequent reporting dates at fair value. Where securities are held for trading purposes, gains and losses arising from changes in fair value are included in the Income statement for the period. A financial asset is classified as held for trading if it has been acquired principally for the purpose of selling in the near future, it is part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short-term profit taking or it is a derivative that is not designated and effective as a hedging instrument. For available-for-sale investments, gains and losses from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the Income statement for the period. Investments with fixed or determinable payments and fixed maturity dates that the Group has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity investments are recorded at amortised cost less any impairment, with revenue recognised on an effective yield basis.

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

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets. 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 to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Cash and cash equivalents

Cash and cash equivalents comprise bank balances held by the Group and money market deposit investments. The carrying amount of these assets approximates to their fair value.

Financial liabilities and equity instruments

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

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

Financial liabilities at FVTPL are stated at fair value, with any resultant gain or loss recognised in the Income statement.

Financial liabilities are measured at FVTPL either because the financial liability is held for trading, or because it is designated to be measured at FVTPL.

A financial liability is classified as held for trading if it has been incurred principally for the purpose of disposal in the near future, it is a part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking or it is a derivative that is not designated and effective as a hedging instrument.

A financial liability other than a financial liability held for trading may be designated as at FVTPL upon initial recognition if such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise exist or the financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis or if it forms part of a contract containing one or more embedded derivatives and IAS 39 permits the entire combined contract to be designated as at FVTPL.

Debt

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

Trade payables

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

Derivative financial instruments and hedge accounting

The Group's activities expose it primarily to the financial risks of changes in interest rates and foreign currency exchange rates. The Group uses interest rate swaps and foreign exchange forward contracts to hedge these exposures.

The use of financial derivatives is governed by the Group's policies approved by the Treasury Committee of the Board, which provide written principles on the use of financial derivatives.

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

2 Significant accounting policies continued

Financial liabilities and equity instruments continued

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

Some derivatives, while complying with the Group's financial risk management policies, do not qualify for hedge accounting and are therefore classified as held for trading.

Changes in the fair value of derivative financial instruments that do not qualify for cash flow hedge accounting are recognised in the Income statement as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the Income statement in the year.

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

Note 22 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 recognised income and expense and in Note 26.

Fair value hedges

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

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 directly in equity and the ineffective portion is recognised immediately in the Income statement, and is included in 'other gains and losses'. If the cash flow hedge of a firm commitment or forecasted transaction results in the recognition of an asset or a liability, then, at the time the asset or liability is recognised, the associated gains or losses on the derivative that had been previously recognised in equity are included in the initial measurement of the asset or liability. For hedges that do not result in the recognition of an asset or a liability, amounts deferred in equity are recognised in the Income statement in the same period in which the hedged items affect net profit or loss.

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.

Key sources of uncertainty

- (i) Property, plant and equipment – the railway network: the estimate of the value in use of the railway network is based on the Regulatory Asset Base, which is, in effect, a discounted future cash flow calculation adjusted for the net present value of any variances from the Office of Rail Regulation's determination included in the Group's Business Plan. Further details are set out in Note 13.
- (ii) Retirement benefit obligation: the Group recognises and discloses its retirement benefit obligation in accordance with the measurement and presentational requirement of IAS 19 'Employee Benefits'. The calculations include a number of judgements and estimations in respect of the expected rate of return on assets, the discount rate, inflation assumptions, the rate of increase in salaries and life expectancy amongst others. Changes in these assumptions can have a significant effect on the value of the retirement benefit obligation. The key assumptions made are set out in Note 31.

3 Revenue

	2008 Group £m	2007 Group £m
Passenger franchise revenue	2,301	2,206
Revenue grants	3,283	3,227
Freight revenue	90	95
Property rental income	219	206
Other income	67	61
	5,960	5,795

The net effect of the performance regimes on the results of the Group was net income of £68m (year to 31 March 2007: £89m).

4 Segmental analysis

No segmental analysis is provided because the Group operates one class of business, that of managing the national rail infrastructure, and undertakes that class of business in one geographical segment, Great Britain.

5 Net operating costs

	2008 Group £m	2007 Group £m
Employee costs (see Note 7)	1,536	1,401
Own costs capitalised	(575)	(482)
Other external charges (including infrastructure maintenance costs)	1,603	1,691
Other operating income	(175)	(148)
Net operating costs before depreciation	2,389	2,462
Depreciation and other amounts written off non-current assets	1,195	1,086
Capital grants amortised	(48)	(43)
Net operating costs	3,536	3,505

6 Profit from operations

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

	2008 Group £m	2007 Group £m
Research and development costs	1	1
Depreciation and other amounts written off property, plant and equipment	1,195	1,086
Amortisation of intangible fixed assets	1	2
Profit on sale of properties	(62)	(47)
Decrease/(increase) in the fair value of investment properties	28	(55)
Cost of inventories recognised as an expense	184	187
Employee costs (see Note 7)	1,536	1,401
Amounts payable to auditors		
Fees payable to the Company's auditors for the audit of the Company's annual accounts	0.02	0.02
Fees payable to the Company's auditors for other services to the Group		
– The audit of the Company's subsidiaries pursuant to legislation	0.39	0.39
Total audit fees	0.41	0.41
Other services pursuant to legislation		
– Regulatory accounts audit and interim review	0.12	0.12
– Other	0.01	0.01
Total non-audit fees	0.13	0.13
Total amounts payable to auditors	0.54	0.54

7 Employee costs

The average number of employees (including Executive Directors) was:

	2008 Group Number	2007 Group Number
Management and operation of the railway	34,770	33,446

	2008 Group £m	2007 Group £m
Their aggregate remuneration comprised:		
Wages and salaries	1,297	1,178
Social security costs	113	102
Defined contribution pension costs (see Note 31)	15	11
Defined benefit pension costs – current service costs (see Note 31)	111	110
	1,536	1,401

8 Investment revenue

	2008 Group £m	2007 Group £m
Interest receivable on investments and deposits	90	32
Interest receivable on finance leases	2	2
Expected return on assets less interest on liabilities in respect of defined benefit pension scheme	19	17
	111	51

Investment revenue earned on financial assets analysed by category of asset, is as follows:

	2008 Group £m	2007 Group £m
Available-for-sale financial assets	21	–
Loans and receivables (including cash and bank balances)	54	29
Held-to-maturity investments	17	5
	92	34

9 Other gains and losses

	2008 Group £m	2007 Group £m
Gains arising from ineffective portion of cash flow hedges	25	35
Losses arising from ineffective portion of cash flow hedges	(12)	(49)
Gain on disposal of hedges	8	–
Fair value losses on interest rate swaps transferred from equity	(4)	(4)
Gains/(losses) arising from cash flow hedge accounting	17	(18)
Increase in fair value of fair value hedges	105	–
Increase in fair value of fair value hedged debt	(111)	–
Decrease in fair value of fair value hedges	–	(85)
Decrease in fair value of fair value hedged debt	–	85
Losses arising from fair value hedge accounting	(6)	–
Increase in fair value of derivatives not hedge accounted	58	2
Increase in fair value of non-hedge accounted debt	(33)	–
Decrease in fair value of derivatives not hedge accounted	(5)	(50)
Decrease in fair value of non-hedge accounted debt	1	41
Increase in fair value of non-hedge accounted investments	1	–
Gains/(losses) arising from non-hedge accounting	22	(7)
Total other gains and (losses)	33	(25)

No other gains and losses have been recognised in respect of loans and receivables or held-to-maturity investments other than those disclosed in Note 8 and impairment losses recognised/reversed in respect of trade receivables (see Notes 5 and 19). No gains and losses have been recognised on financial liabilities measured at amortised cost other than those disclosed in Note 10.

The gain/loss arising on adjustment for the hedged item in a designated fair value hedge accounting relationship, the change in fair value of debt designated as fair value through profit and loss, and the exchange differences on retranslation of foreign currency debt forms part of the net gains/losses on other financial liabilities carried at amortised cost and relates to debt issuances disclosed in Note 21.

10 Finance costs

	2008 Group £m	2007 Group £m
Interest on bank loans and overdrafts	71	65
Interest on bonds issued under the Debt Issuance Programme	672	475
Interest on debt issued under the Medium Term Note Programme	253	296
Interest on Commercial Paper	12	78
Interest on obligations under finance leases	16	12
Other interest	82	93
Total borrowing costs	1,106	1,019
Less: amounts included in the cost of qualifying assets	(92)	(75)
Total finance costs	1,014	944

Borrowing costs are included in the costs of qualifying assets to the extent that the asset is financed by the Group. The average rate used during the year was 5.0% (2007: 5.0%).

11 Tax

	2008 Group £m	2007 Group £m
Current tax:		
UK Corporation tax at 30% (2007: 30%):		
Corporation tax charge	(19)	(17)
Less advance corporation tax (ACT) set-off	13	7
Corporation tax liability	(6)	(10)
Total current tax	(6)	(10)
Deferred tax:		
Deferred tax at 28% (2007: 30%):		
Current year charge	(445)	(423)
Change of corporation tax rate	28	–
Prior year credit/(charge)	18	(9)
Total deferred tax	(399)	(432)
Total tax	(405)	(442)

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

	2008 Group £m	2007 Group £m
Profit before tax	1,588	1,474
Tax at the UK corporation tax rate of 28% (2007: 30%)	444	442
Adjustments in respect of prior years	(18)	9
Change of corporation tax rate	(28)	–
Permanent differences	20	(2)
Advance corporation tax previously written off	(13)	(7)
Tax charge for the year	405	442

In addition to the amounts charged to the Income statement, deferred tax relating to the revaluation of the railway network amounting to £113m (2007: £19m) has been charged directly to equity. Movements on the hedging reserve amounting to £7m (2007: £50m charge), movements relating to retirement benefit obligations amounting to £37m (2007: £37m charge) and £132m (2007: £nil) relating to the impact of corporation tax rate change on brought forward deferred tax balances have been credited directly to equity.

Deferred tax is calculated at a rate of 28% (2007: 30%). 28% (2007: 30%) is also used for the reconciliation above as the tax charge is substantially deferred tax.

UK corporation tax is calculated at 30% (2007: 30%).

The Group has £26m (2007: £39m) of surplus ACT carried forward. No deferred tax asset has been provided in respect of this amount as it is uncertain that it can be utilised against tax liabilities in the foreseeable future.

12 Intangible assets

Group	Concessions £m
Cost	
At 1 April 2006 and 1 April 2007	83
Fully written down licences de-recognised in the year	(5)
At 31 March 2008	78
Amortisation	
At 1 April 2006	(6)
Charge for the year	(2)
At 1 April 2007	(8)
Charge for the year	(1)
Fully written down licences de-recognised in the year	5
At 31 March 2008	(4)
Carrying amount	
At 31 March 2008	74
At 31 March 2007	75

The intangible assets above are held by the Company's wholly owned subsidiary Network Rail (CTRL) Limited.

The concession to run the operations, maintenance and renewal business of the Channel Tunnel Rail Link is being amortised over 84 years to 2086.

13 Property, plant and equipment – the railway network

	Group £m	Company £m
Valuation		
At 1 April 2006	25,991	–
Additions	3,326	–
Depreciation charge for the year	(1,086)	–
Revaluation in the year	73	–
At 1 April 2007	28,304	–
Additions	3,952	–
Depreciation charge for the year	(1,195)	–
Transfers to investment property	(21)	–
Revaluation in the year	403	–
At 31 March 2008	31,443	–

In the year ended 31 March 2003 Ove Arup and Partners reviewed Network Rail Infrastructure Limited's engineering assessment of the replacement cost, depreciated replacement cost and useful economic lives of all the assets that comprise the railway network and confirmed in writing to the Directors that the basis upon which the assessment had been prepared was appropriate and that the resultant valuations and estimates were reasonable.

Ove Arup and Partners carried out an interim review in the year ended 31 March 2005 of the Company's engineering assessment of the replacement cost, depreciated replacement cost and useful economic lives of the railway network assets. This interim review updated the full review carried out in the year ended 31 March 2003. Ove Arup and Partners confirmed in writing that the basis upon which the assessment was prepared continued to be appropriate and that there had been no material changes to the valuations and estimates derived in the year ended 31 March 2003.

The Directors have reviewed the assessments in the current year and are satisfied that they remain valid and appropriate at 31 March 2008. A full review of the valuation and asset lives is prepared and externally verified as required.

The unimpaired depreciated replacement cost of the network (after excluding the replacement cost of embankments, cuttings and tunnels) is estimated at £63bn.

13 Property, plant and equipment – the railway network continued

As the depreciated replacement cost of the railway network significantly exceeds its value in use, it is impaired down to its value in use at each reporting date. Given the interdependency of the assets comprising the railway network, the Group has concluded that the railway network is a single cash generating unit and that its value in use is the estimated future cash flows that will be generated in perpetuity, discounted at the Group's pre-tax cost of capital, as set by the Office of Rail Regulation (ORR) in its Access Charges Review. The estimate of the value in use is based on the Regulatory Asset Base (RAB) which is, in effect, a discounted future cash flow calculation adjusted for the net present value of any variances from the ORR's Determination included in the Group's Business Plans.

The depreciation charge for any year is calculated using the average carrying value for the year and the estimated weighted average remaining useful economic life of the railway network. The estimated remaining weighted average useful economic life of the network is currently 25 years (2007: 25 years).

As at 31 March 2008 the comparable valuation of the railway network according to the historic cost convention is £25,748m.

As at 31 March 2008 and 31 March 2007 it is not possible to identify the undepreciated capitalised interest or the undepreciated finance leases, within the net book value of fixed assets. The undepreciated interest capitalised since the date of adoption of the network value as deemed cost on 1 April 2002 was £278m (2007: £195m). No finance leased assets have been acquired since 1 April 2002.

At 31 March 2008, the Group had entered into contractual commitments in respect of capital expenditure amounting to £1,130m (2007: £1,077m).

14 Investment property

	Group £m	Company £m
Fair value		
At 1 April 2006	892	–
Additions	5	–
Disposals	(4)	–
Increase in fair value in the year	55	–
At 1 April 2007	948	–
Additions	9	–
Transfers from property, plant and equipment	21	–
Disposals	(1)	–
Decrease in fair value in the year	(28)	–
At 31 March 2008	949	–

The fair value of the Group's investment properties at 31 March 2008 has been arrived at on the basis of a valuation carried out at that date by Jones Lang LaSalle, external valuers not connected with the Group, and by a qualified chartered surveyor working for Network Rail.

The valuation which conforms to International Valuation Standards, was arrived at by, firstly, the external valuation of the 15 largest properties amounting to 14% of the total valuation. Secondly, the balance of the estate, amounting to 6,420 properties, was valued using the Beacon method. The portfolio was analysed into 12 homogenous classes of property and areas. Jones Lang LaSalle independently assessed the appropriate yield to be adopted within each of the portfolio classes/areas in order to enable the Directors to estimate market values by applying the adopted yields to the net rental income in accordance with a traditional UK investment property valuation.

The property rental income earned by the Group from its investment property, all of which is leased out under operating leases, amounted to £74m (2007: £72m). Direct operating expenses arising on the investment properties in the year amounted to £4.4m (2007: £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.

15 Investment in subsidiaries: Company

At cost
£m

Investment in subsidiaries at 1 April 2006, 1 April 2007 and 31 March 2008

The Company's subsidiaries are set out below:

Directly owned	Country of incorporation	Proportion of all classes of issued share capital owned by the Company	Principal activity
Network Rail Holdco Limited	Great Britain	100%	Holding company
Network Rail CP Finance PLC	Great Britain	100%	Administration of Commercial Paper programme
Railway Safety & Standards	Great Britain	Company limited by guarantee	Dormant
Railway Safety	Great Britain	Company limited by guarantee	Dormant
Held through subsidiary			
Network Rail Infrastructure Limited	Great Britain	100%	Management of the UK railway infrastructure
Network Rail Insurance Limited	Guernsey	100%	Insurance
Network Rail (CTRL) Limited	Great Britain	100%	Holds St Pancras concession and CTRL Railway Services Agreement
Network Rail (Spacia) Limited	Great Britain	100%	Dormant
Network Rail (Stations) Limited	Great Britain	100%	Dormant
Network Rail (Projects) Limited	Great Britain	100%	Dormant
Network Rail (Property) Limited	Great Britain	100%	Dormant
Spacia (2002) Limited	Great Britain	100%	Dormant
Network Rail Defined Contribution Pension Scheme Trustee Limited	Great Britain	Company limited by guarantee	Administration of defined contribution pension scheme
Shares held by a trustee			
Network Rail MTN Finance PLC	Great Britain	Shares held by HSBC Trustee (C.I.) Limited	Administration of Medium Term Note Programme
Network Rail Infrastructure Finance PLC	Great Britain	Shares held by HSBC Trustee (C.I.) Limited	Administration of Debt Issuance Programme

The shares in Network Rail MTN Finance PLC and Network Rail Infrastructure Finance PLC are held by HSBC Trustee (C.I.) Limited for charitable purposes. The sole activity of these companies is to act as a special purpose funding vehicle, including issuing debt under the Medium Term Note Programme and the Debt Issuance Programme respectively. The companies are treated as subsidiaries for accounting purposes as proceeds from the Medium Term Note Programme and the Debt Issuance Programme are on-lent to Network Rail Infrastructure Limited and are used to finance the activities of that Company and to refinance the existing debt of the Group.

16 Investments

	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
Held-to-maturity investments carried at amortised cost	8	—	—	—
Available-for-sale financial assets carried at fair value	47	—	—	—
Total investments	55	—	—	—

The Group has not designated any financial assets that are not held for trading as financial assets at fair value through profit or loss.

The held-to-maturity investments consist of one item with a maturity date of August 2008 that returns a fixed rate of interest (5.6%).

Available-for-sale financial assets comprise instruments with a maturity profile of between 103 and 341 days from the Balance sheet date. All available-for-sale financial assets carry a fixed rate of return. The weighted average interest rate is 4.1%.

17 Inventories

	2008 Group £m	2007 Group £m
Raw materials and consumables	64	49

All raw materials and consumables are held by Network Rail Infrastructure Limited.

18 Finance lease receivables

	Minimum lease payments		Present value of minimum lease payments	
	2008 Group £m	2007 Group £m	2008 Group £m	2007 Group £m
Amounts receivable under finance leases:				
Within one year	5	5	3	3
In the second to fifth years inclusive	10	13	8	10
After five years	5	7	4	6
	20	25	15	19
Less: unearned finance income	(4)	(6)	n/a	n/a
Present value of minimum lease payments receivable	16	19	15	19
Analysed as:				
Current finance lease receivables (recoverable within one year)			3	3
Non-current finance lease receivables (recoverable after one year)			12	16
			15	19

The Group has entered into finance lease arrangements with third parties for various types of telecommunications equipment. Leases are due to expire in 2017/18.

The interest rate inherent in the leases is fixed at the contract date for all of the lease term. The average effective interest rate contracted is approximately 8.4% (2007: 8.4%) per annum.

Finance lease receivable balances are secured over the equipment leased. The Group is not permitted to sell or repledge the collateral in the absence of default by the lessee.

The fair value of the Group's finance lease receivables at 31 March 2008 is estimated at £13m (2007: £16m) using a 5.0% (2007: 5.0%) discount rate based on the current average cost of capital.

19 Other assets

Trade and other receivables

	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
Trade receivables	318	320	—	—
Capital grants receivable	77	43	—	—
Other receivables	199	162	—	—
Prepayments and accrued income	90	105	—	—
	684	630	—	—

Trade receivables include an allowance for estimated irrecoverable amounts from the supply of services of £5m (2007: £4m). This allowance has been made by reference to past default experience. Average debtor days were 44 days (2007: 37 days).

The Directors consider that the carrying value of trade and other receivables approximates their fair value. All balances are non interest bearing and denominated in sterling. The Group provides fully for receivables overdue by over six months because historical experience is that such receivables are generally not recoverable. All other trade receivables are provided for on the basis of estimated irrecoverable amounts, determined by reference to past default experience.

The Group's credit risk is primarily attributable to its trade receivables. Around 94% of the Group's income is received from Train Operating Companies (TOCs) and in the form of revenue grants from Government. Franchises are issued to TOCs by the Department for Transport in England and Wales and Transport Scotland in Scotland. The Group believes that amounts receivable from Government and the TOCs represent a high level of credit quality. This is because in the event that a TOC was financially distressed and unable to meet its obligations then provisions in the franchise agreements allow the DfT to take over services at any time. Before accepting any other new customer, the Group uses an external credit scoring system to assess the potential customer's credit quality.

Included in the Group's trade receivable balance are debtors with a carrying value of £24m (2007: £13m) 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 85 days (2007: 75 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:

	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
Past due by 1-28 days	10	7	—	—
Past due by 29-56 days	4	2	—	—
Past due by 57-84 days	4	1	—	—
Past due by 85-180 days	6	3	—	—
	24	13	—	—

20 Trade and other payables

Current liabilities: Trade and other payables

	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
Trade creditors	594	621	–	–
Payments received on account	17	12	–	–
Taxation and social security	31	38	–	–
Other creditors	354	325	–	–
Other interest accruals	252	227	–	–
Other accruals and deferred income	1,136	987	–	–
	2,384	2,210	–	–

The average credit period taken for trade purchases is 44 days (2007: 51 days).

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

	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
Deferred development income	39	87	–	–
Capital grants deferred income	1,510	1,197	–	–
Other payables	114	90	–	–
	1,663	1,374	–	–

21 Bank loans and overdrafts

	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
Bank loans and overdrafts	1,415	1,503	–	–
Bonds issued under the Debt Issuance Programme (less unamortised discount and fees)	14,662	10,794	–	–
Debt issued under the Medium Term Note Programme (less unamortised discount and fees)	4,072	4,826	–	–
Commercial Paper	–	1,260	–	–
Kreditanstalt für Wiederaufbau working capital facility	200	215	–	–
	20,349	18,598	–	–

The borrowings are repayable as follows:

On demand or due within one year	5,082	2,867	–	–
Due within one to two years	1,162	4,724	–	–
Due within two to five years	2,791	3,053	–	–
Due in more than five years	11,314	7,954	–	–
	20,349	18,598	–	–

Less: amounts repayable within one year (shown under current liabilities):

Bank loans and overdrafts	(105)	(105)	–	–
Bonds issued under the Debt Issuance Programme (less unamortised discount and fees)	(705)	(399)	–	–
Debt issued under the Medium Term Note Programme (less unamortised discount and fees)	(4,072)	(888)	–	–
Commercial Paper	–	(1,260)	–	–
Kreditanstalt für Wiederaufbau working capital facility	(200)	(215)	–	–
Amounts repayable within one year	(5,082)	(2,867)	–	–
Amounts repayable after more than one year	15,267	15,731	–	–

All borrowings are denominated in or swapped into sterling.

21 Bank loans and overdrafts continued

Bonds issued under the Debt Issuance Programme are analysed as follows*:

	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
1.085% sterling index linked bond due 2052	102	—	—	—
0% sterling index linked bond due 2052	101	—	—	—
0% sterling index linked bond due 2051	101	—	—	—
1.125% sterling index linked bond due 2047	509	—	—	—
0% sterling index linked bond due 2047	62	—	—	—
1.5646% sterling index linked bond due 2044	217	207	—	—
1.2219% sterling index linked bond due 2040	217	207	—	—
4.6535% sterling bond due 2038	100	—	—	—
1.375% sterling index linked bond due 2037	1,012	—	—	—
7.05% US dollar bond due 2036	12	13	—	—
6.91% US dollar bond due 2036	12	13	—	—
4.75% sterling bond due 2035	1,221	1,220	—	—
1.6492% sterling index linked bond due 2035	328	315	—	—
4.375% sterling bond due 2030	868	868	—	—
1.75% sterling index linked bond due 2027	1,545	—	—	—
4.57% Norwegian krone bond due 2026	13	11	—	—
4.615% Norwegian krone bond due 2026	47	40	—	—
1.9618% sterling index linked bond due 2025	276	264	—	—
4.75% sterling bond due 2024	722	720	—	—
4.3775% sterling bond due 2023	200	200	—	—
2.28% Japanese yen bond due 2021	51	43	—	—
2.315% Japanese yen bond due 2021	54	45	—	—
2.15% Japanese yen bond due 2021	51	43	—	—
2.76% Swiss franc bond due 2021	140	123	—	—
4.625% sterling bond due 2020	995	995	—	—
5.0575% US dollar bond due 2017	25	24	—	—
4.40% Canadian dollar bond due 2016	254	219	—	—
6% Australian dollar bond due 2016	217	202	—	—
4.875% sterling bond due 2015	989	988	—	—
4.375% sterling bond due 2011	447	446	—	—
5.25% US dollar bond due 2011	545	515	—	—
3% US dollar bond due 2011	502	—	—	—
5.50% Australian dollar bond due 2010	391	349	—	—
5.125% sterling bond due 2010	498	498	—	—
3.875% US dollar bond due 2009	504	507	—	—
4.875% US dollar bond due 2009	654	636	—	—
4.46% sterling bond due 2008	50	50	—	—
4.125% US dollar bond due 2008	630	634	—	—
4.50% sterling bond due 2008	—	399	—	—
	14,662	10,794	—	—

*Amounts are shown net of unamortised discount and fees.

21 Bank loans and overdrafts continued

Debt issued under the Medium Term Note Programme is analysed as follows*:

	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
4 7/8% sterling Medium Term Note due 2009	2,084	2,244	—	—
3 1/8% euro Medium Term Note due 2009	1,988	1,694	—	—
2 5/8% US dollar Medium Term Note due 2008	—	634	—	—
2 5/8% US dollar Medium Term Note due 2008	—	254	—	—
	4,072	4,826	—	—

* Amounts are shown net of unamortised discount and fees.

Bank loans are analysed as follows:

	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
Index-linked European Investment Bank due 2037	369	353	—	—
HSBC Bank due 2019 repayable by instalments	206	206	—	—
Barclays Bank due 2017 repayable by instalments	55	55	—	—
Royal Bank of Scotland due 2017 repayable by instalments	68	68	—	—
5.57% European Investment Bank due 2013	204	205	—	—
5.77% European Investment Bank due 2012	306	307	—	—
6.42% European Investment Bank due 2011	102	103	—	—
6.42% European Investment Bank due 2009	101	101	—	—
European Investment Bank due 2007	—	100	—	—
	1,411	1,498	—	—

The weighted average interest rates on borrowings at 31 March 2008 and 31 March 2007 were as follows:

	2008 Group %	2007 Group %	2008 Company %	2007 Company %
Bank loans and overdrafts	5.24	5.45	—	—
Debt issued under the Debt Issuance Programme	4.93	4.85	—	—
Debt issued under the Medium Term Note Programme	5.18	5.25	—	—
Debt issued under the Commercial Paper Programme	—	5.25	—	—

21 Bank loans and overdrafts continued

At 31 March 2008 and 31 March 2007 the Group had the following undrawn committed borrowing facilities.

	2008 Drawn £m	2008 Undrawn £m	2008 Total £m	2007 Drawn £m	2007 Undrawn £m	2007 Total £m
Working capital facility	–	1,000	1,000	–	1,000	1,000
Standby facility A	–	4,000	4,000	–	4,000	4,000
	–	5,000	5,000	–	5,000	5,000

Undrawn committed facilities expire as follows:

	2008 £m	2007 £m
Within one year	1,000	1,000
Within one to two years	–	–
Within two to five years	4,000	4,000
	5,000	5,000

In addition the Secretary of State for Transport has provided support facilities in respect of the facilities listed below:

- unlimited financial indemnity in respect of borrowings under the Debt Issuance Programme
- Medium Term Note Programme
- £1,050m European Investment Bank
- £200m Kreditanstalt für Wiederaufbau.

The support facilities provided by the Secretary of State for Transport cover amounts payable under the relevant facilities.

22 Derivative financial instruments

	2008 Group	Notional amounts £m
	Fair value £m	
Cash flow hedges		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	18	391
Cross-currency swaps to hedge debt issued under the Medium Term Note Programme	289	1,990
Interest rate swaps	19	1,890
Forward starting interest rate swaps	6	150
Fair value hedges		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	22	382
Forward starting cross-currency swaps	25	750
Non-hedge accounted derivatives		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	22	240
Forward starting cross-currency swaps	4	61
	405	5,854
Included in non-current assets	98	–
Included in current assets	307	–
Derivative financial instrument assets	405	–

Cash flow hedges		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	(73)	1,638
Forward starting interest rate swaps	(10)	1,425
Fair value hedges		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	(44)	1,380
Non-hedge accounted derivatives		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	(2)	27
	(129)	4,470
Included in current liabilities	(69)	–
Included in non-current liabilities	(60)	–
Derivative financial instrument liabilities	(129)	–

	2008 Group		2007 Group	
	Fair value £m	Notional amounts £m	Fair value £m	Notional amounts £m
Cash flow hedges				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	(55)	2,029	(63)	3,376
Cross-currency swaps to hedge debt issued under the Medium Term Note programme	289	1,990	(93)	2,642
Forward starting interest rate swaps	(4)	1,575	5	1,487
Interest rate swaps	19	1,890	8	400
Forward starting cross-currency swaps	–	–	1	547
Fair value hedges				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	(22)	1,762	(92)	1,786
Forward starting cross-currency swaps	25	750	–	–
Non-hedge accounted derivatives				
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	20	267	(28)	1,539
Forward starting cross-currency swaps	4	61	–	–
	276	10,324	(262)	11,777

23 Provisions

	Environmental provision £m	Other provisions £m	Total £m
At 1 April 2006	17	22	39
Additional provision in the year	–	13	13
Utilisation/release of provision	(17)	(2)	(19)
At 1 April 2007	–	33	33
Additional provision in the year	–	2	2
Utilisation/release of provision	–	(23)	(23)
At 31 March 2008	–	12	12
Included in current liabilities	–	12	12
Included in non-current liabilities	–	–	–
	–	12	12

The Group have provided against a number of commercial claims from third parties included in other provisions for which settlement is expected to be achieved in the next year.

The Group had previously provided for the anticipated costs of remedial works on land inherited from the British Railways Board which has suffered contamination, and where contractual or other obligations require the Group to clear up these sites. Following a review of the planned expenditure, it is estimated that all costs have been incurred and so no further provision is required.

The Company has no provisions at 31 March 2008 and 31 March 2007.

24 Deferred tax

The following are the major deferred tax liabilities and assets recognised by the Group and movement thereon during the current and prior years.

	Accelerated tax depreciation £m	Revaluation of railway network £m	Short term timing differences including retirement benefit obligations £m	Derivatives £m	Tax losses £m	Total £m
At 1 April 2006	2,264	1,861	(122)	(70)	(2,044)	1,889
Charge/(credit) to income	276	–	(4)	(10)	170	432
Charge/(credit) to equity	61	(42)	37	51	–	107
At 1 April 2007	2,601	1,819	(89)	(29)	(1,874)	2,428
Charge to income	49	–	17	8	325	399
Charge/(credit) to equity	42	(65)	(37)	(4)	2	(62)
At 31 March 2008	2,692	1,754	(109)	(25)	(1,547)	2,765

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

	2008 £m	2007 £m
Deferred tax liabilities	4,446	4,420
Deferred tax assets	(1,681)	(1,992)
	2,765	2,428

Network Rail Infrastructure Limited has a potential deferred tax asset relating to the disposal of the track bed which is carried at zero in the accounts. It is not possible to determine reliably the tax base of the asset which would be determined by negotiation with HM Revenue and Customs and therefore it has not been possible to reliably quantify the potential deferred tax asset.

25 Obligations under finance leases

	Minimum lease payments		Present value of minimum lease payments	
	2008 £m	2007 £m	2008 £m	2007 £m
Amounts payable under finance leases:				
Within one year	1	1	–	–
In the second to fifth years inclusive	4	4	2	2
After five years	9	10	7	8
	14	15	9	10
Less: future finance charges	(5)	(5)	n/a	n/a
Present value of lease obligations	9	10	9	10
Less: amounts repayable within one year (shown under current liabilities)			–	–
Amounts repayable after more than one year			9	10

The Group leases certain fixtures and fittings under finance leases from third parties. All lease obligations are denominated in sterling. The fair value of the Group's lease obligations approximates their carrying amount. The Group's obligations under finance leases are secured by the lessors' charges over the leased assets. For the year ended 31 March 2008, the effective borrowing rate was 5.1% (2007: 5.1%). Interest rates are fixed at contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rent payments.

26 Reconciliation of changes in equity

Group	Revaluation Reserve £m	Other Reserve* £m	Hedging Reserve £m	Retained Earnings £m	Total £m
At 1 April 2006	3,696	242	(178)	3	3,763
Revaluation of the railway network	73	–	–	–	73
Transfer of deemed cost depreciation from revaluation reserve	(205)	–	–	205	–
Increase in deferred tax liability on the railway network	42	–	–	(61)	(19)
Actuarial gains on defined benefit pension schemes	–	–	–	122	122
Deferred tax on actuarial gains	–	–	–	(37)	(37)
Decrease in fair value of hedging derivatives	–	–	(183)	–	(183)
Exchange differences on retranslation of foreign currency debt	–	–	351	–	351
Deferred taxation on all hedging reserve movements/retained earnings	–	–	(50)	–	(50)
Transfers					
Recycling of balances in hedging reserve to other gains and losses in the Income statement	–	–	4	–	4
Deferred tax on transfers	–	–	(1)	–	(1)
Net profit for the year	–	–	–	1,032	1,032
At 31 March 2007	3,606	242	(57)	1,264	5,055
Impact of change in tax rate	121	7	(2)	6	132
Revaluation of the railway network	403	–	–	–	403
Transfer of deemed cost depreciation from revaluation reserve	(204)	–	–	204	–
Increase in deferred tax liability on the railway network	(56)	–	–	(57)	(113)
Actuarial losses on defined benefit pension schemes	–	–	–	(133)	(133)
Deferred tax on actuarial losses	–	–	–	37	37
Increase in fair value of hedging derivatives	–	–	370	–	370
Exchange differences on retranslation of foreign currency debt	–	–	(393)	–	(393)
Deferred taxation on all hedging reserve movements/retained earnings	–	–	7	–	7
Transfers					
Recycling of balances in hedging reserve to other gains and losses in the Income statement	–	–	4	–	4
Deferred tax on transfers	–	–	(1)	–	(1)
Net profit for the year	–	–	–	1,183	1,183
At 31 March 2008	3,870	249	(72)	2,504	6,551

* Other reserves of £249m comprise the vesting reserve (2007: £242m) on privatisation.

There have been no changes in the Company equity and, therefore, no Company only reconciliation has been presented.

27 Notes to the Cash flow statement

	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
Operating profit from operations	2,424	2,290	–	–
Adjustments for:				
Depreciation of the railway network	1,195	1,086	–	–
Amortisation of capital grants	(48)	(43)	–	–
Amortisation of intangible assets	1	2	–	–
Decrease in provisions	(21)	(6)	–	–
Operating cash flows before movements in working capital	3,551	3,329	–	–
Increase in inventories	(15)	(5)	–	–
Increase in receivables	(10)	(177)	–	–
(Decrease)/increase in payables	(202)	94	–	–
Cash generated from operations	3,324	3,241	–	–
Income taxes paid	(4)	–	–	–
Interest paid	(886)	(813)	–	–
Net cash generated from operating activities	2,434	2,428	–	–

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 and money market deposit investments with an average maturity of 29 days from the Balance sheet date (2007: 2 days).

28 Analysis of changes in net debt

	At 1 April 2007 £m	Cash flows £m	Non cash movements £m	Capital accretion £m	Amortisation of discount £m	Fair value remeasurements £m	Foreign exchange differences £m	At 31 March 2008 £m
Cash and cash equivalents	193	350	–	–	–	–	–	543
Borrowings due within one year	(2,867)	2,914	(4,746)	–	(20)	(1)	(362)	(5,082)
Borrowings due after one year	(15,731)	(3,944)	4,750	(151)	(18)	(142)	(31)	(15,267)
Obligations under finance leases	(10)	1	–	–	–	–	–	(9)
Financial investments	–	53	–	–	1	–	1	55
	(18,415)	(626)	4	(151)	(37)	(143)	(392)	(19,760)

	At 1 April 2006 £m	Cash flows £m	Non cash movements £m	Capital accretion £m	Amortisation of discount £m	Fair value remeasurements £m	Foreign exchange differences £m	At 31 March 2007 £m
Cash and cash equivalents	31	162	–	–	–	–	–	193
Borrowings due within one year	(4,191)	2,733	(1,502)	–	(80)	–	173	(2,867)
Borrowings due after one year	(14,219)	(3,268)	1,501	(36)	(13)	105	199	(15,731)
Obligations under finance leases	(10)	–	–	–	–	–	–	(10)
Available-for-sale investments	161	(161)	–	–	–	–	–	–
	(18,228)	(534)	(1)	(36)	(93)	105	372	(18,415)

29 Operating lease arrangements

The Group as lessee	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
Minimum lease payments under operating leases recognised in the income statement in the year	49	38	–	–

At the Balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
Within one year	49	36	–	–
In the second to fifth years inclusive	103	64	–	–
After five years	42	48	–	–
	194	148	–	–

Operating lease payments largely represent rentals payable by the Group for certain of its office properties. Leases are negotiated for an average term of seven years and rentals fixed for an average of three years. In addition rentals are paid for land adjacent to the railway as required for maintenance and renewal activities.

The Group as lessor

Operating lease rentals earned in the year by the Group was £542m (2007: £516m). The majority of this income is earned from station and depot leases to train operating companies. Further rentals are earned from investment properties, other station lettings, advertising, telecoms and rail contractors.

At the Balance sheet date, the Group had contracted with customers for the following future minimum lease payments:

	2008 Group £m	2007 Group £m	2008 Company £m	2007 Company £m
Within one year	409	420	–	–
In the second to fifth years inclusive	1,162	1,188	–	–
After five years	1,459	1,667	–	–
	3,030	3,275	–	–

30 Funding and financial risk management

Introduction

The Company is limited by guarantee without shareholders. The Group is almost entirely debt funded. Debt is issued through special purpose financing companies (Network Rail Infrastructure Finance PLC and Network Rail MTN Finance PLC) which are not members of the Network Rail Limited Group but are treated as subsidiaries for accounting purposes. The majority of the Group's debt is issued by Network Rail Infrastructure Finance PLC under the Debt Issuance Programme (DIP) which has been highly rated (AAA by Standard & Poor's, Aaa by Moody's and AAA by Fitch). The DIP is supported by a financial indemnity from the Secretary of State for Transport which expires in 2052.

The DIP allows access, through a single platform, to the widest possible sources of funding, at the lowest possible cost, including the long term capital markets. This gives Network Rail a stable base for funding a continuing programme of long-term investments in the national rail network. This results in debt being 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 (see below).

Externally imposed capital requirements

The Regulatory Asset Base (RAB) is the Regulator's valuation of Network Rail's assets. This is an important business ratio because the value of the RAB and the amount of debt that the business can sustain are very closely related. Generally speaking, Network Rail's debts cannot exceed the value of the RAB; a debt to RAB ratio of significantly less than 100 per cent indicates that the business is more robust to future cost shocks (because it is more likely to be able to sustain the additional debt that would arise from any losses incurred).

The Group owns and operates Britain's rail network under licence from the Office of Rail Regulation (ORR). The licence imposes conditions on the Group with regard to its net debt. Should the value of the Company's net debt exceed 85% of the ORR's RAB then the ORR will be formally notified.

The Group's debt to RAB ratio at 31 March 2008 and 2007 were as follows:

	2008	2007
Debt: RAB ratio	69.4%	73.5%

Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in Note 2 to the financial statements.

30 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 2008 and 31 March 2007.

The fair values of the financial assets and liabilities are included at the amount at which the instrument could be exchanged for 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:

- cash and cash equivalents – approximates to the carrying amount
- commercial paper/working capital facility – approximates to the carrying value because of short maturity of these instruments
- bank loans and overdraft – 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 obtained from dealing banks
- debt issued under Medium Term Note Programme – based on market data at the Balance sheet date
- loans and receivables and payables – approximates to the carrying value
- lease receivables/obligations – approximates to the carrying value
- derivatives – based on market data at the Balance sheet date.

Group	2008		2007	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Cash and cash equivalents	543	543	193	193
Other non-derivative financial assets:				
Finance lease receivables	15	15	19	19
Held-to-maturity investments	8	8	–	–
Available-for-sale financial assets	47	47	–	–
Trade and other receivables	594	594	525	525
Derivatives				
Derivatives designated as cash flow hedging instruments	332	332	42	42
Derivatives designated as fair value hedging instruments	47	47	–	–
Other derivatives	26	26	–	–
Total derivatives	405	405	42	42
Total financial assets	1,612	1,612	779	779
Financial liabilities				
Financial liabilities held at amortised cost:				
Commercial paper	–	–	(1,260)	(1,260)
Obligations under finance leases	(9)	(9)	(10)	(10)
Working capital facility	(200)	(200)	(215)	(215)
Bank loans and overdrafts	(1,415)	(1,481)	(1,503)	(1,513)
Bonds issued under the Debt Issuance Programme*	(13,254)	(13,743)	(9,516)	(9,551)
Debt issued under Medium Term Note Programme*	(4,072)	(4,065)	(4,826)	(4,758)
Financial liabilities designated as fair value through profit and loss:				
Bonds issued under the Debt Issuance Programme*	(1,408)	(1,408)	(1,278)	(1,278)
Total borrowing	(20,358)	(20,906)	(18,608)	(18,585)
Trade and other payables	(2,498)	(2,498)	(2,300)	(2,300)
Derivatives				
Derivatives designated as cash flow hedging instruments	(83)	(83)	(92)	(92)
Derivatives designated as fair value hedging instruments	(44)	(44)	(184)	(184)
Other derivatives	(2)	(2)	(28)	(28)
Total derivatives	(129)	(129)	(304)	(304)
Total financial liabilities	(22,985)	(23,533)	(21,212)	(21,189)

* Amounts are shown net of unamortised discount and fees.

Derivatives

The Group 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. 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'), have approved and monitor the risk management processes, including documented treasury policies, counterparty limits, controlling and reporting structures.

30 Funding and financial risk management continued

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

The credit risk with regard to all classes of derivative financial instruments and other funds is limited because counterparties are banks with high credit ratings assigned by international credit-rating agencies. The Treasury Committee authorises the policy for setting counterparty limits based on credit-ratings. The Group spreads its exposure over a number of counterparties, and have strict policies on how much exposure can be assigned to each counterparty. The concentration and amount of the Group's investments varies depending on the level of surplus liquidity the Group chooses to hold at any point in time. However, because of the strict criteria governing counterparties suitability the risk is mitigated. The Treasury Committee also authorises the investment and borrowing instruments that can be used.

For debt designated as fair value through profit or loss there has been no change as a result of credit risk changes. The losses in the Income statement arising from the re-measurement of FVTPL debt items of £32m (2007: gains of £41m) are all attributable to changes in market risk.

Foreign exchange risk

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

It is estimated that a general increase of ten percentage points in the value of any currency against sterling would have no material effect on the Group's profit before tax or equity due to all currency positions being 100% hedged.

Interest rate 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 £20,092m (2007: £18,369m) is arranged at or swapped into fixed interest rates and exposes the Group to fair value interest rate risk. Other borrowings were arranged at floating rates, thus exposing the Group to cash flow interest rate risk.

The Group has interest rate swaps of £3,485m maturing over the next two years. Under these swaps the Group pays an average fixed rate of 5.06%.

The sensitivity analysis below has been determined based on the exposure to interest rates for both derivatives and non-derivative instruments at the Balance sheet date. A 1% increase or decrease represents management's assessment of the reasonably possible changes in average interest rates.

Sensitivity analysis

If average interest rates had been 1% higher and all other variables were held constant, the Group's profit before tax for the year ended 31 March 2008 would decrease by £6m (2007: £13m).

The Group's sensitivity to interest rates has decreased during the period as all new long-term debt raised in the year were issued at fixed or inflation-linked interest rates.

Inflation rate risk

The Group has certain debt issuances which are index-linked and so is 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.

The sensitivity analysis below has been determined based on the exposure to inflation rates for both derivatives and non-derivative instruments at the Balance sheet date. A 1% increase or decrease represents management's assessment of the reasonably possible changes in inflation rates.

Sensitivity analysis

If RPI had been 1% higher and all other variables were held constant, the Group's finance costs for the year ended 31 March 2008 would increase by £52m (2007: £12m) and other than a corresponding movement in the profit and loss reserve there would be no impact on the equity.

The Group's sensitivity to inflation rates has increased during the period due to further issuances of index-linked debt instruments.

The Group believes that the above analysis is unrepresentative of the risks inherent in issuing index-linked debt. Passenger franchise revenue and revenue grants constitute £5,584m (2007: £5,433m) of revenue which is far in excess of an index-linked interest expense of £137m (2007: £36m). Currently, these sources of income are contractually index-linked and whilst there is no absolute contractual guarantee for future regulatory Control Periods that this will continue, the Group are highly confident that this will remain to be the case. Therefore, the natural hedge that exists between finance costs and revenue mitigates the risk of Retail Price Index movements.

30 Funding and financial risk management continued

Liquidity risk management

The ultimate responsibility for liquidity risk management rests with the Board of Directors. The policy manual ratified by the Treasury Committee includes an appropriate liquidity risk management framework covering the Group's short, medium and long-term funding and liquidity management requirements. Treasury is subject to regular internal audits. Group policy is to ensure that there are sufficient facilities and short-term investments to cover, as a minimum, the next 12 months' funding requirements. Treasury ensures sufficient liquidity is available to meet the Group's needs, while reducing financial risks and prudently optimising the balance between interest receivable and credit risk on surplus cash.

The Group manages liquidity risk by maintaining sufficient banking facilities to cover at least one year's working capital requirement by continuously monitoring forecast and actual cash flows and matching maturity profiles of financial assets and liabilities. Included in Note 21 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 fair values. 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 2008					
Sterling denominated DIP bonds	339	287	1,720	8,348	10,694
Sterling denominated index-linked bonds	66	68	219	12,695	13,048
Foreign currency denominated bonds	831	1,283	1,634	1,180	4,928
Effect of foreign currency swaps on foreign currency denominated bonds	93	70	32	(235)	(40)
	924	1,353	1,666	945	4,888
Medium Term Notes	4,412	–	–	–	4,412
Effect of foreign currency swaps on Medium Term Notes	(285)	–	–	–	(285)
	4,127	–	–	–	4,127
Bank loans and overdrafts	147	56	548	1,757	2,508
Effect of interest rate swaps on bank loans and overdrafts	–	–	–	1	1
	147	56	548	1,758	2,509
Working capital facility	221	–	–	–	221
Finance lease liabilities	1	1	3	9	14
Trade and other payables	2,132	114	–	–	2,246
	7,957	1,879	4,156	23,755	37,747
Effect of discount/financing costs/derivatives	(743)	(603)	(1,363)	(12,434)	(15,143)
	7,214	1,276	2,793	11,321	22,604

30 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 2007					
Sterling denominated DIP bonds	690	335	1,752	8,367	11,144
Sterling denominated index-linked bonds	17	17	55	3,095	3,184
Foreign currency denominated bonds	156	791	2,303	1,121	4,371
Effect of foreign currency swaps on foreign currency denominated bonds	19	76	125	142	362
Effect of interest rate swaps on foreign currency denominated bonds	(1)	(1)	–	–	(2)
	174	866	2,428	1,263	4,731
Medium Term Notes	1,075	4,111	–	–	5,186
Effect of foreign currency swaps on Medium Term Notes	139	16	–	–	155
	1,214	4,127	–	–	5,341
Bank loans and overdrafts	166	162	262	2,064	2,654
Effect of interest rate swaps on bank loans and overdrafts	–	1	2	1	4
	166	163	264	2,065	2,658
Commercial Paper	1,269	–	–	–	1,269
Effect of foreign currency swaps on Commercial Paper	3	–	–	–	3
	1,272	–	–	–	1,272
Working capital facility	221	–	–	–	221
Finance lease liabilities	1	1	3	10	15
Trade and other payables	1,983	90	–	–	2,073
	5,738	5,599	4,502	14,800	30,639
Effect of discount/financing costs/derivatives	(888)	(785)	(1,447)	(6,838)	(9,958)
	4,850	4,814	3,055	7,962	20,681

Cash flow hedges

The following table shows the contractual maturities of payments under cash flow hedges for the Group:

Cash flow hedging reserve	2008 Group £m	2007 Group £m
Less than one year	24	15
One to two years	3	1
Two to five years	2	(2)
More than five years	43	43
	72	57

Borrowings

Details of the Group's undrawn committed facilities and types of debt instrument used can be found in Note 21.

Hedge ineffectiveness

At 31 March 2008 the Group has recognised a net gain of £13m (2007: net loss of £14m) relating to ineffectiveness arising from the Group's cash flow hedges in the Income statement.

30 Funding and financial risk management continued

Derivative maturity

The interest rate and foreign exchange derivatives have the following maturities:

	2008 Group		2007 Group	
	Fair value £m	Notional amounts £m	Fair value £m	Notional amounts £m
Interest rate derivatives:				
Less than one year	(2)	1,825	4	300
One to five years	17	1,640	10	1,465
More than five years	–	–	–	–
	15	3,465	14	1,765
Foreign exchange derivatives:				
Less than one year	240	2,914	(105)	2,252
One to five years	(17)	3,075	(151)	6,678
More than five years	38	870	(20)	1,082
	261	6,859	(276)	10,012

31 Retirement benefit schemes

Defined contribution schemes

With effect from 1 April 2004 the Group introduced a defined contribution pension scheme, the Network Rail Defined Contribution Pension Scheme (NRDCPS). This scheme is the only Company-sponsored pension 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 to the NRDCPS is entitled to do so.

At 31 March 2008, the NRDCPS has 10,163 members (2007: 8,495) and the average employer contribution rate in the year was 5.7% (2007: 5.6%).

Defined benefit schemes

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

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

Since 1 April 2004, new members can only join the Network Rail Section of the RPS after completing five years' service. Benefits for existing members and employees joining up to and including 31 March 2004 were not affected by the revised eligibility rules of the Network Rail Section. In addition to deferring entry to the scheme to new employees the Group 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 Group will continue to match regular contributions but will not increase them in cash terms in the future.

A revised triennial actuarial valuation of the Network Rail Section by the scheme actuary was underway at 31 December 2007. The results of this are expected in September 2008. Qualified actuaries Watson Wyatt have valued the scheme on an IAS19 basis at 31 March 2008 and 31 March 2007.

The total contribution rate payable under the RPS is normally split in the proportion 60:40 between the Group and the members. The Group reflects its share of the contribution in the financial statements.

The Group and members pay contributions of 16.2% (2007: 15.51%) and 10.8% (2007: 10.34%) of section pay respectively as at 31 March 2008.

31 Retirement benefit schemes continued

Defined benefit schemes continued

If a surplus or deficit arises, the provisions in the RPS rules mean that the Group and members benefit from or pay for this respectively in the proportion 60:40.

	2008 %	2007 %
Key assumptions used:		
Discount rate	6.90	5.40
Expected return on equity assets	8.50	8.00
Expected return on bond assets	4.10	4.40
Expected return on property assets	6.30	6.20
Expected rate of price inflation	3.70	3.20
Future earnings increases*	5.20	4.70
Future pension increases	3.70	3.20

* Inclusive of a promotional salary scale of 0.5% per annum.

	2008		2007	
	Males	Females	Males	Females
Average life expectancy for mortality tables used to determine defined benefit obligations:				
Member aged 65 now	20.5	23.2	17.8	20.1
Member aged 65 in 20 years' time	24.4	27.0	18.7	21.2

Amounts recognised in income in respect of the Group's pension arrangements are as follows:

	2008 £m	2007 £m
Current service cost	126	121
Interest cost	116	102
Expected return on scheme assets	(135)	(119)
Past service costs	—	—
	107	104

The current service cost has been included in employee costs, the expected return on scheme assets less interest on liabilities has been included in finance costs.

Actuarial gains and losses have been reported in the Statement of recognised income and expense.

The amount included in the Balance sheet arising from the Group's obligations in respect of its defined benefit scheme is as follows:

	2008 £m	2007 £m
The defined benefit obligation is made up as follows:		
Active members	(2,550)	(2,523)
Deferred pensioner members	(282)	(253)
Retired members	(740)	(648)
Present value of defined benefit obligation	(3,572)	(3,424)
Fair value of scheme assets	2,955	3,010
Deficit in the scheme	(617)	(414)
Company's share (60%) of the scheme deficit recognised in the Balance sheet	(370)	(248)

This amount is presented in the Balance sheet as follows:

	2008 £m	2007 £m
Included in current liabilities	—	—
Included in non-current liabilities	(370)	(248)
	(370)	(248)

Cumulative gains or losses are recognised in equity.

31 Retirement benefit schemes continued

Defined benefit schemes continued

Movements in the present value of defined benefit obligations (including members' share) in the current year were as follows:

	2008 £m	2007 £m
At 1 April	(3,424)	(3,234)
Current service cost including members' share	(194)	(188)
Interest cost	(193)	(169)
Actual benefit payments	75	56
Actuarial gains and losses	164	111
Past service cost	—	—
At 31 March	(3,572)	(3,424)

Movements in the present value of fair value of scheme assets in the current year were as follows:

	2008 £m	2007 £m
At 1 April	3,010	2,635
Expected return on scheme assets	225	198
Actuarial gains and losses	(380)	87
Contributions from scheme members	57	54
Contributions from employer	118	92
Actual benefit payments	(75)	(56)
At 31 March	2,955	3,010

The analysis of the scheme assets and the expected rate of return at the Balance sheet date was as follows:

	Expected return		Fair value of assets	
	2008 %	2007 %	2008 £m	2007 £m
Equity instruments	8.50	8.00	2,266	2,332
Debt instruments	4.10	4.40	388	372
Property	6.30	6.20	291	296
Other	4.70	4.20	10	10
			2,955	3,010

The expected return on assets assumption was determined as the average of the expected returns on the assets held by the Network Rail Section on the accounting date. The rates of return for each class are set out in the table above and were determined as follows:

- equities and property: The rate adopted is consistent with the median assumption used in Watson Wyatt's Asset Liability Modelling work
- bonds: The overall rate has been set to reflect the yields on the bond holdings
- other assets: This class is mostly made up of cash holdings and the rate adopted reflects current short-term returns on such deposits.

Actuarial assumption sensitivity

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

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

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

	2008 £m
Discount rate	
Decrease in defined benefit obligation at year end from a 25 basis points increase	156
Increase in defined benefit obligation at year end from a 25 basis points decrease	164
Mortality	
Increase in defined benefit obligation from a one year increase in longevity	71
Decrease in defined benefit obligation from a one year decrease in longevity	77

31 Retirement benefit schemes continued

Defined benefit schemes continued

The history of experience adjustments is as follows:

	2008 £m	2007 £m	2006 £m	2005 £m
Present value of defined benefit obligations	(3,572)	(3,424)	(3,234)	(2,527)
Fair value of scheme assets	2,955	3,010	2,635	1,849
Deficit in the scheme	(617)	(414)	(599)	(678)
Group's share (60%) of the scheme deficit recognised in the Balance sheet	(370)	(248)	(359)	(414)
Experience adjustments on scheme liabilities				
Amount (£m)	(114)	(14)	(67)	(217)
Percentage of scheme liabilities	3.19%	0.41%	2.07%	8.59%
Experience adjustments on scheme assets				
Amount (£m)	(222)	52	229	79
Percentage of scheme assets	(7.51)%	1.73%	8.69%	4.27%

The estimated amounts of contributions expected to be paid by the Group and members to the scheme during the year ended 31 March 2009 are £118m and £60m.

32 Related party transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. The Company considers its key management personnel to be its Directors. Details of their remuneration can be found in the Directors' remuneration report (see page 24).

Company information

Calendar 2008/09

4 April 2008

Publication of Strategic Business Plan update

6 June 2008

Preliminary results announcement for full year to 31 March 2008

16 July 2008

Annual General Meeting of Network Rail Limited

November 2008

Results for half-year announcement to 30 September 2008

